US Weekly Flash

Highlights

Headline and Core Prices Continue to Trend Below Target

- For the second straight month, the headline consumer price index for February increased by a modest 0.1%. However, this time around the increase was driven by a jump in food prices, which were up 0.4% to mark the fastest monthly pace since August 2011. Gasoline prices mitigated this increase, falling 1.7% MoM and dropping 8.1% on a YoY basis. The low gas price environment is not here to stay, and we expect a rebound in the coming months to cause upward bias on inflation as we move forward. Looking at the core inflation figure, the consumer price index also inched upward by 0.1% on a MoM basis. Shelter prices continue to outpace other components of core inflation, up 0.2% MoM and 2.6% YoY in February.
- On a yearly basis, core inflation is now up only 1.6% YoY, and with regards to monetary policy, is trending far below the Fed's desirable target. After fears that post-recession monetary policy might cause a significant increase in inflation, we have seen just the opposite—overall inflation has been trending far lower than expected. While we still do not expect the Fed to alter monetary policy based solely on low inflation, the decreasing pace of inflation certainly warrants attention. For a more in-depth analysis on inflation, please see our latest brief.

FOMC Meeting: Yellen Starts Her Chairmanship with Strong Move on Guidance

- The March FOMC meeting marked Yellen's first as Chair and set an interesting tone for the start or her term. As we had expected, the Committee, faced with a faster-than-expected decline in the unemployment rate, acknowledged that the 6.5% unemployment rate threshold had become outdated. In turn, FOMC members agreed to "update" forward guidance thresholds with a reference to progress "toward its objectives of maximum employment and 2 percent inflation", thus removing the numeric threshold for unemployment. To avoid confusion in market expectations, the Committee concluded the statement with an additional paragraph restating that eliminating the 6.5% unemployment rate threshold from its guidance "does not indicate any change in the Committee's policy intentions as set forth in its recent statements."
- Despite the overall dovish undertone during Chair Yellen's press-conference, she remarks in the Q&A session that QE3 could end in the fall and that "considerable time" means six months, both statements which are surprisingly hawkish as they imply that policy tightening could happen as early as 1H15. However, drawing any significant conclusion from this is premature given that the rate hike is still conditional on upbeat economic data and no risk of disinflation. Moreover, she could have meant "at least six months" thus setting the first rate hike in 2Q15, only slightly earlier than market expectations.
- Overall, as the tapering path is set, the FOMC focus is shifting towards crafting an effective communication strategy for policy tightening. Assuming that the Fed maintains the $10bn per month incremental reductions, asset purchases will likely continue until 4Q14. For now, our expectation for the first federal funds rate hike remains in 3Q15. To avoid an unwanted steepening in the yield curve, as the FOMC begins to increase the federal funds rate, the trajectory of federal funds rate will remain below the levels that the Committee would view as normal in the long-run.

Industrial Production Recovers in February as Manufacturing Component Strengthens

- Industrial production rose more than expected for February, increasing 0.6% from the month prior. The jump was led by the manufacturing sector, up 0.8% as both the durable and nondurable goods components bounced back from declines. Durable manufactured goods increased by 0.9%, led by a 4.9% increase in motor vehicles and parts for the month, while nondurables gained 0.7%.
- While we expected to see an increase in industrial production and the manufacturing component, February's data surpassed our expectations to the upside. The recent decline in industrial production had investors worried about sluggish growth, particularly in manufacturing, but February's data confirmed our belief there are no reasons to panic about a long-term slowdown. The utilities component helped keep the sector afloat through the winter, but we expect a reversal in trends as we move into the year, as utilities will provide a downward bias on the headline industrial output figure offset by the rebound in manufacturing activity.

Week Ahead

New Home Sales (February, Tuesday 10:00 ET)

Forecast: 460K	Consensus: 445K	Previous: 468K

Following the unexpected surge in January, we expect a slight downturn in new home sales for February, partially because the lingering winter weather should correct for some of this early 2014 gain. Sales in the new home market surprised to the upside in January, rising by 9.6% MoM, reaching the highest one-month sale level since 2008. Looking ahead, mortgage rates have dropped considerably between January and February, so we expect the drop in rates to spur demand at least for the short-term. Furthermore, median home prices have dropped over 11% off their 2013 highs, so consumers who previously found houses unaffordable will be more likely to enter the market moving forward. For February, however, we certainly do not see an increase in new home sales as strong as last month, but we still project the recovery to continue gradually throughout the coming year.

Durable Goods Orders, Ex Transportation (February, Wednesday 8:30 ET)

Forecast: 0.9%, 0.4%	Consensus: 0.7%, 0.3%	Previous: -1.0%, 1.0%

Durable goods new orders have stumbled throughout three of the last four months, and givent he volatility of the series on a month-to-month basis, we expect to see a slight reversal in February. In particular, we are likely to see a rebound in aircraft orders following two consecutive months of large declines in the component. The auto industry has also shown some increased momentum in February and should help lift the headline figure. Excluding transportation, total durable goods orders have remained mostly stagnant since last May, though still hovering near recovery high levels. Overall, we expect durable goods orders excluding transportation to increase but at a slightly slower pace than the headline figure, particularly after manufacturing data released for February showed a pickup in activity.

GDP Final (4Q13, Thursday 8:30 ET)

Forecast: 2.3%	Consensus: 2.7%	Previous: 2.4%

The final real GDP estimate for 4Q13 is expected to shift downward only slightly, closing out 2013 at 1.9% annual growth. The preliminary estimate revised GDP significantly from 3.2% to 2.4%, but this was driven primarily by a drop in personal consumption expenditures, revised downward from 3.3% to 2.6% for the quarter. Monthly consumer spending was revised for December from 0.4% to 0.1% MoM, which is the primary reason we expect a downward GDP revision for the final estimate. However, construction spending shot up from 0.1% to 1.5% MoM for December and therefore should provide a strong upward bias to the final GDP estimate and at least partially cancel out the drop in consumer spending. Finally, business inventories and personal income remained unrevised for December, so neither one of these variables will bias GDP one way or another. Given that most data should already be accounted for, we don't expect to see much change for the final 4Q13 GDP report.

Personal Income and Outlays (February, Friday 8:30 ET)

Forecast: 0.2%, 0.2%	Consensus: 0.3%, 0.3%	Previous: 0.3%, 0.4%

After gains in January for personal income and outlays, we expect to see continued upward movement in both components for February, though at a slightly slower pace. Overall, personal income and spending data have remained strong over the past year, and both components have provided reassurance in the economic recovery. After a quick drop in the stock market in January amid concerns overseas, the stock market rebounded strong in February, and as consumers feel wealthier, they typically become more inclined to spend. Furthermore, consumer confidence indicators suggest gradual yet increasing sentiments regarding the strength of the economy, particularly for expectations six months ahead. Given that we do not expect a significant surprise from the income or spending figures, the key factor to keep an eye on in this report is the PCE price index, particularly as it relates to the Fed's monetary policy strategy for tapering and forward guidance.

Market Impact

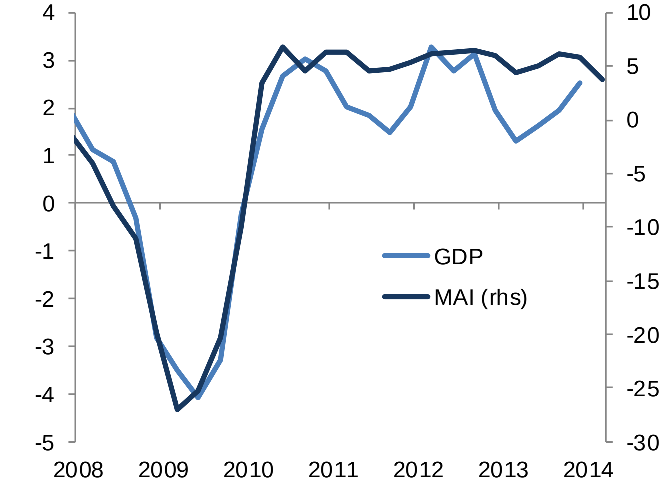
Markets this week will be heavily focused on interpreting the comments from the March FOMC statement, hoping for some clarity from additional Fedspeak. A significant movement in the final GDP estimate for 4Q13 could also influence markets, though less so given that most of the data has already been priced in. Finally, markets will continue to keep an eye overseas and watch the development of the situation in Russia and Ukraine.

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)

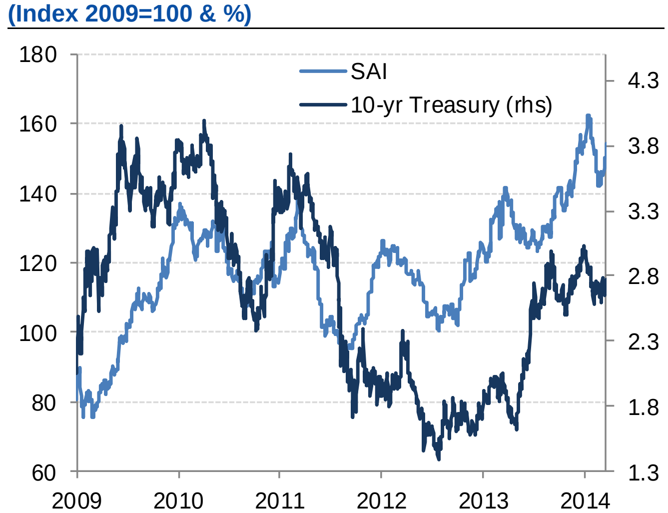


Source: BBVA Research & BEA

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

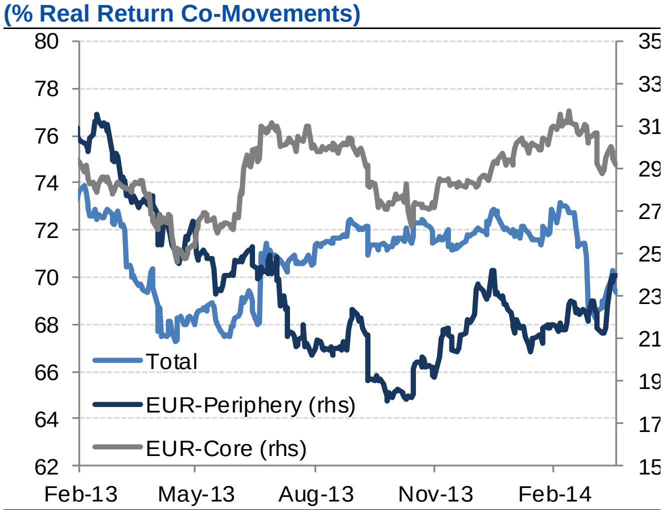
Source: BBVA Research

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



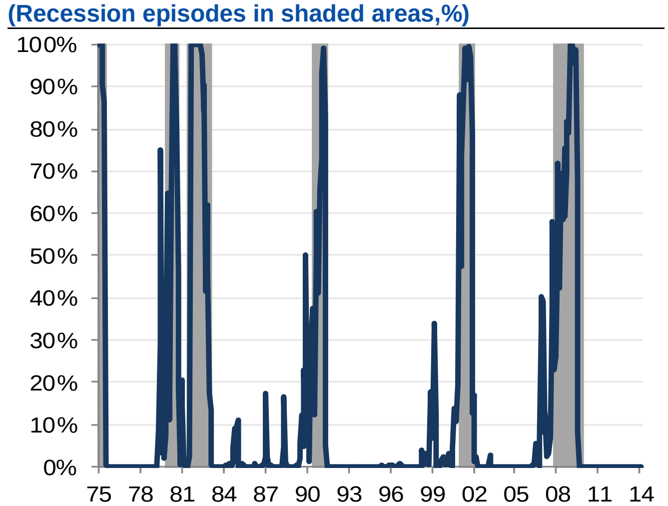
Source: Bloomberg & BBVA Research

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



Source: BBVA Research

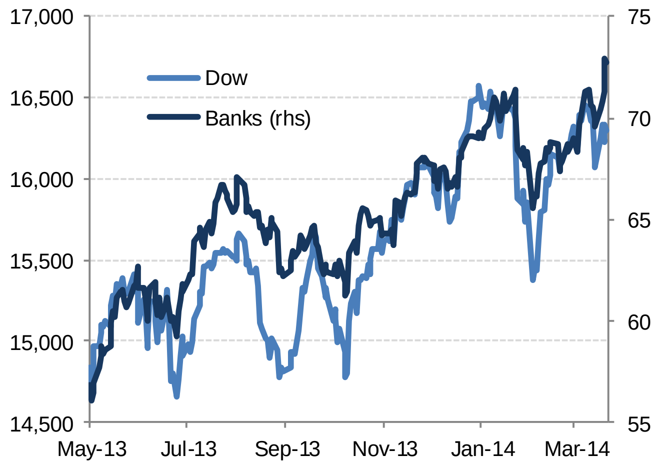
Graph 8
BBVA US Recession Probability Model
(Recession episodes in shaded areas,%)



Source: BBVA Research

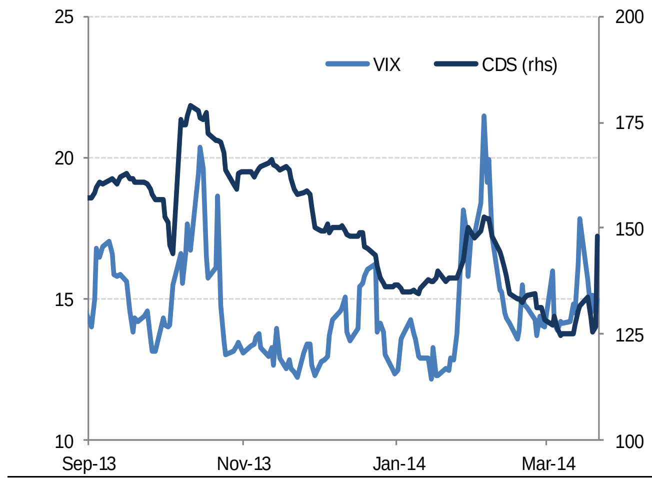
Financial Markets

Graph 9
Stocks (Index, KBW)



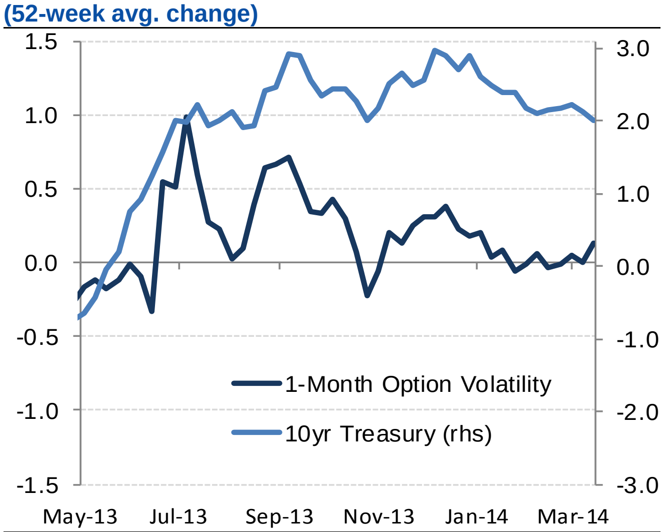
Source: Bloomberg & BBVA Research

Graph 10
Volatility & High-Volatility CDS (Indices)



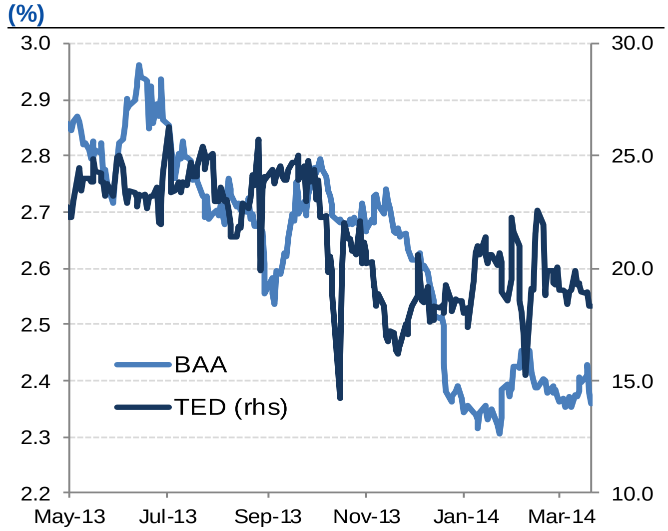
Source: Bloomberg & BBVA Research

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



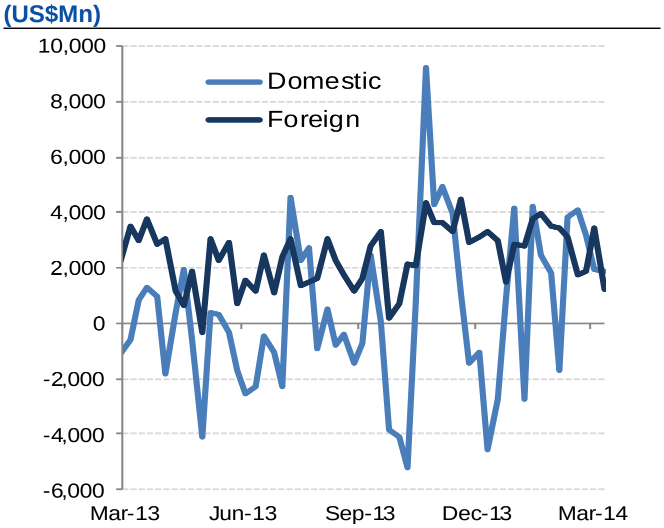
Source: Haver Analytics & BBVA Research

Graph 12
TED & BAA Spreads (%)



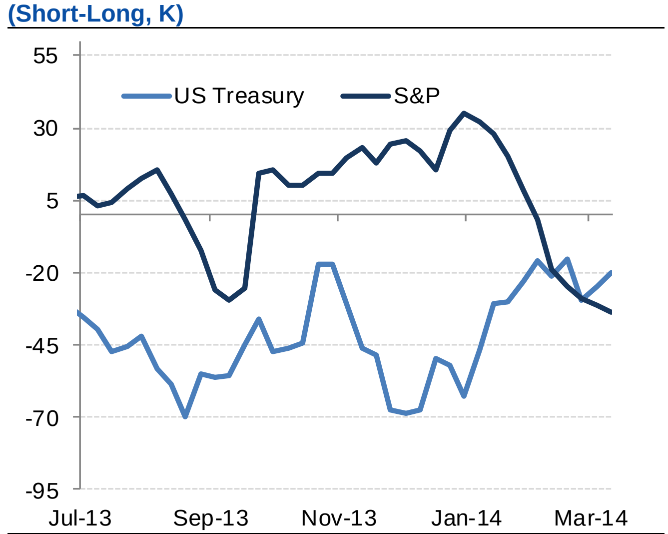
Source: Bloomberg & BBVA Research

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



Source: Haver Analytics & BBVA Research

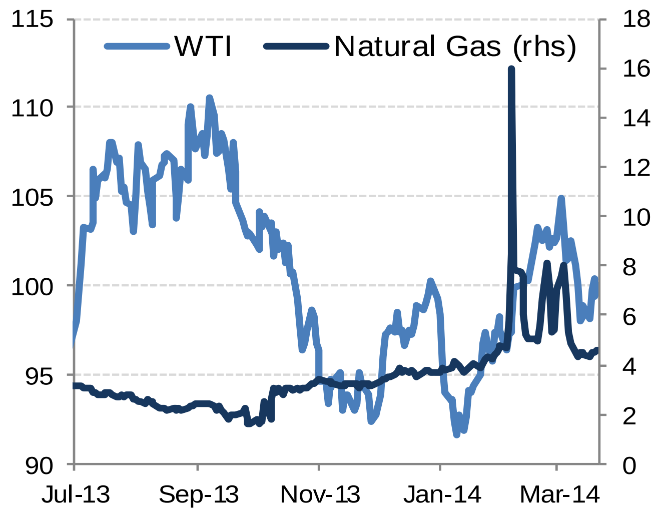
Graph 14
Total Reportable Short & Long Positions (Short-Long, K)



Source: Haver Analytics & BBVA Research

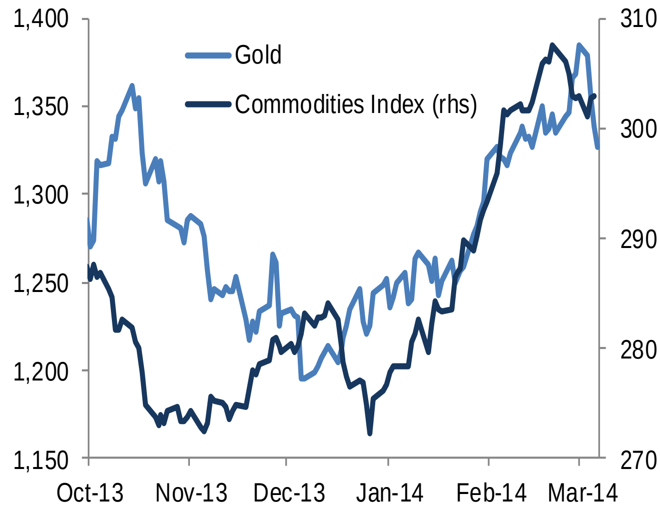
Financial Markets

Graph 15
Commodities
(Dpb & DpMMBtu)



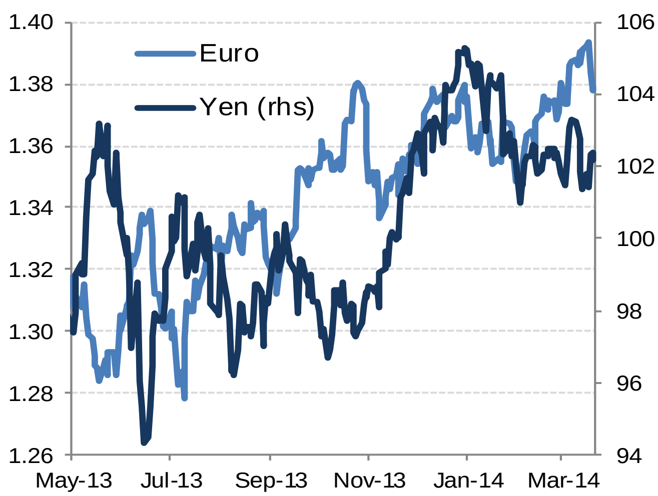
Source: Bloomberg & BBVA Research

Graph 16
Gold & Commodities
(US$ & Index)



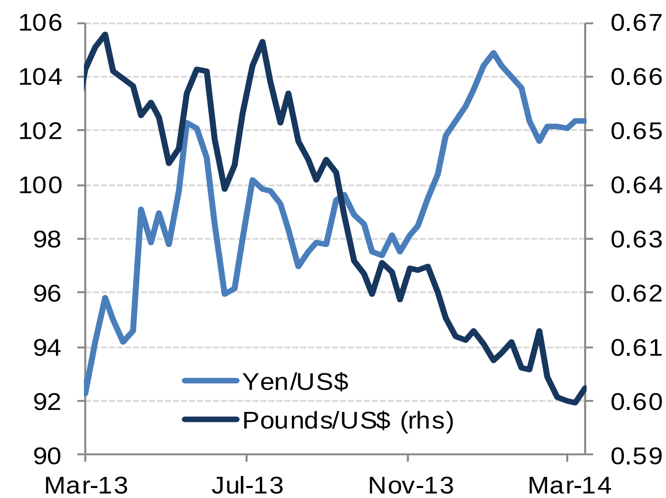
Source: Haver Analytics & BBVA Research

Graph 17
Currencies
(Dpe & Ypd)



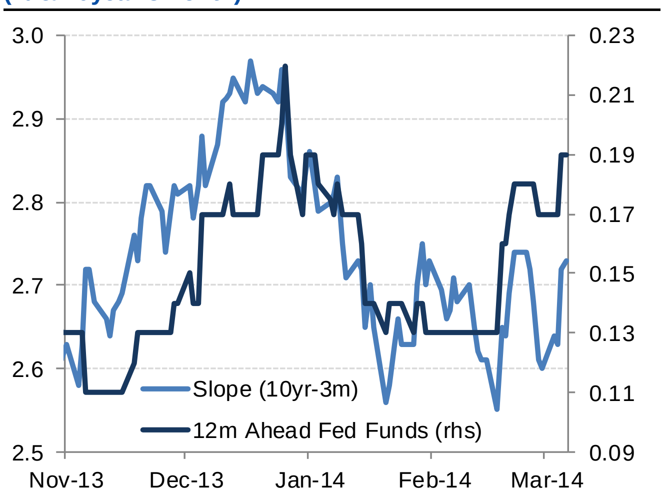
Source: Bloomberg & BBVA Research

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



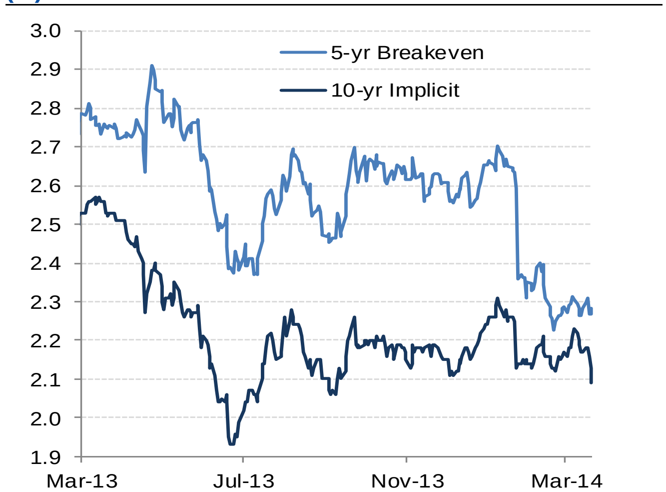
Source: Haver Analytics & BBVA Research

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)	14.23	14.23	14.23	14.10
New Auto (36-months)	2.75	2.47	2.39	2.46
Heloc Loan 30K	5.29	5.40	5.35	5.24
5/1 ARM *	3.02	3.09	3.08	2.90
15-year Fixed Mortgage *	3.32	3.38	3.35	3.23
30-year Fixed Mortgage *	4.32	4.37	4.33	3.99
Money Market	0.41	0.40	0.41	0.50
2-year CD	0.77	0.77	0.80	0.66

*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	0.08	0.08	0.07	0.15
3M Libor	0.23	0.23	0.23	0.28
6M Libor	0.33	0.33	0.33	0.45
12M Libor	0.56	0.56	0.56	0.73
2yr Sw ap	0.56	0.48	0.45	0.43
5yr Sw ap	1.80	1.63	1.64	0.98
10Yr Sw ap	2.86	2.77	2.83	2.07
30yr Sw ap	3.58	3.57	3.66	3.05
30day CP	0.11	0.12	0.11	0.16
60day CP	0.14	0.12	0.11	0.17
90day CP	0.16	0.13	0.13	0.18

Source: Bloomberg & BBVA Research

Quote of the Week

Richard Fisher, President of the Federal Reserve Bank of Dallas
'Sloppier' New Guidance Has Advantages
21 March 2014

"What we are trying to do now is to articulate the best we can what happens after our massive QE. What we have done is we have de-quantified our guidance and are seeking to provide qualitative indicators of how we might proceed…by its very nature qualitative guidance will be a little bit sloppy…you cannot expect specific quantitative guidance without mistakes being made."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
24-Mar	Chicago Fed National Acitivty Index	FEB	0.05	0.10	-0.39
25-Mar	S&P Case-Shiller HPI (YoY)	JAN	13.10%	13.40%	13.42%
25-Mar	New Home Sales	FEB	460K	445K	468K
25-Mar	New Home Sales (MoM)	FEB	-1.70%	-4.90%	9.60%
25-Mar	Consumer Confidence	MAR	79.00	78.50	78.10
26-Mar	Durable Goods Orders (MoM)	FEB	0.90%	0.70%	-1.00%
26-Mar	Durable Goods Orders, Ex Transportation (MoM)	FEB	0.40%	0.30%	1.10%
27-Mar	Real GDP QoQ Annualized	4Q F	2.30%	2.70%	2.40%
27-Mar	Personal Consumption	4Q F	2.50%	2.70%	2.60%
27-Mar	GDP Price Index	4Q F	1.60%	1.60%	1.60%
27-Mar	Core PCE QoQ	4Q F	1.30%	1.30%	1.30%
27-Mar	Initial Jobless Claims	22-Mar	330K	322K	320K
27-Mar	Continuing Claims	15-Mar	2895K	2880K	2889K
27-Mar	Pending Home Sales (MoM)	FEB	0.20%	0.10%	0.10%
28-Mar	Personal Income (MoM)	FEB	0.20%	0.30%	0.30%
28-Mar	Personal Spending (MoM)	FEB	0.20%	0.30%	0.40%
28-Mar	U. of Michigan Consumer Sentiment	MAR	80.3	80.5	79.9

Forecasts

	2011	2012	2013	2014	2015	2016
Real GDP (% SAAR)	1.8	2.8	1.9	**2.5**	**2.5**	**2.8**
CPI (YoY %)	3.1	2.1	1.5	**2.3**	**2.4**	**2.4**
CPI Core (YoY %)	1.7	2.1	1.8	**2.3**	**2.4**	**2.3**
Unemployment Rate (%)	8.9	8.1	7.4	**6.7**	**6.2**	**5.7**
Fed Target Rate (eop, %)	0.25	0.25	0.25	**0.25**	**0.50**	**1.50**
10Yr Treasury (eop, % Yield)	1.98	1.72	3.03	**3.50**	**3.80**	**4.10**
US Dollar/ Euro (eop)	1.31	1.31	1.37	**1.31**	**1.35**	**1.37**

Note: Bold numbers reflect actual data. Forecast revisions pending.

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