Economic Research Department

BBVA

GDP Observatory

July 24, 2008

GDP growth in 2Q08

- **Boosted by tax rebates and monetary policy, consumer spending proved resilient in 2Q08**
- **Non-residential investment was solid, while residential investment declined**
- **Risks are tilted to the downside, we expect GDP to weaken in 2H08**

2Q08 GDP Growth

Advance:	**July 31**
Preliminary:	August 28
Final:	September 26

Economic activity in the second quarter

According to our estimates, the U.S. economy proved resilient in the second quarter. We expect 0.93% real GDP growth in 2Q08 from 0.96% in 1Q08. This is equivalent to 1.8% year-over-year growth rate in 2Q08 from 2.5% in 1Q08.

Our estimates suggest that personal consumption expenditures' (PCE) growth accelerated to 1.5% in 2Q08 from 1.1% in 1Q08. Tax rebates and lower interest rates may have boosted consumers' spending despite rising energy costs and job losses. The fiscal stimulus seemed to have had a positive impact on demand for non-durable goods and services; however, it wasn't enough to revive durable goods purchases. For instance, auto sales fell 7.2% in the quarter, the sharpest decline since December 2005.

We expect a moderation of non-residential investment (NRI) to a 2.0% growth rate in 2Q08 from a 4.2% in 1Q08. Real capital goods orders posted strong gains in the first quarter, anticipating a sustained expansion of NRI in the next quarter. However, on a year-over-year basis, we expect NRI to have decelerated to a 5.3% growth rate from a 7.5% rate in the previous quarter.

In 2Q08, residential investment (RI) most likely subtracted to GDP growth as the housing adjustment continued. Housing starts declined 3.5% from the previous quarter, equivalent to a 30.4% reduction from the level observed a year earlier. Residential investment probably declined another 20.9%.

Foreign trade dynamics continued to favor GDP growth. We expect a 3.4% rise in exports from the 5.5% rise in 1Q08. This rate would have been boosted by sustained growth overseas. Meanwhile, we expect a further 3.4% reduction in imports, from the 0.7% reduction in 1Q08. Dollar depreciation and a weaker demand would be the main drivers for such outcome.

Further weakness going forward

Factors behind GDP resiliency in 2Q07 are merely transitory. The effect of tax rebates is likely to fade away amid rising energy prices and slower income growth, thus PCE could decelerate significantly in the coming quarters. Moreover, ongoing financial distress has added significant pressures to our main scenario. Non-residential investment is likely to be impaired by rising costs of funding, while residential investment will continue subtracting to GDP growth. On the positive side however, net exports will be supportive, though exports could moderate in the next few quarters as economic growth abroad soften.

Leading Indicators
12-month % change

	Jun	May	Apr	1Q08
PCE (real)		2.2	1.9	1.9
Retail sales	3.0	2.1	2.8	3.0
Retail sales ex. autos & gasoline	6.2	4.8	5.4	4.5
Capital goods new orders*		2.3	1.3	3.2
New orders, nonmanuf. ISM (index)	48.6	53.6	50.1	47.8
Housing starts	-26.9	-32.0	-32.5	-27.4
Residential construction	5.1	3.0	1.6	-0.6
Business inventories ($ bn)		5.1	6.8	7.9
Manufacturing inventories ($ bn)		28.1	-1.6	50.4
Federal public spending	-16.0	25.1	18.7	3.4
Goods exports (real)		10.3	11.7	10.0
Goods imports (real)		-2.3	-0.5	-1.0

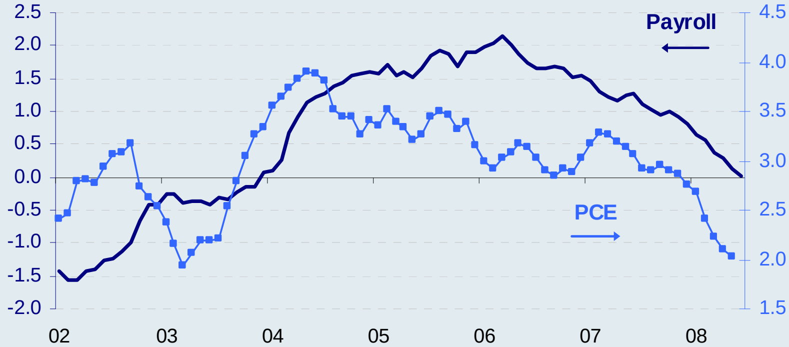
* Nondefense excluding aircraft

Gross Domestic Product
Quarterly annualized rate, sa — forecasts in bold

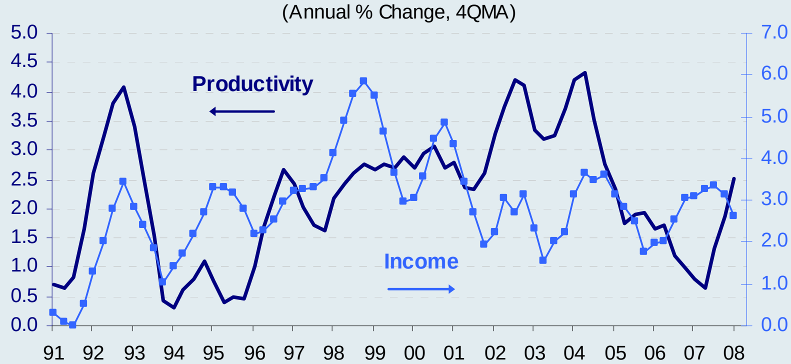
	2Q08	**1Q08**	**4Q07**	**3Q07**	**2Q07**
GDP	**0.9**	1.0	0.6	4.9	3.8
Personal spending	**1.5**	1.1	2.3	2.8	1.4
Nonresidential investment	**2.0**	0.5	6.0	9.4	11.0
Residential investment	**-20.9**	-24.5	-25.2	-20.5	-11.8
Inventories ($ bn)	**-35.0**	-19.6	-18.3	30.6	5.8
Public spending	**1.0**	2.1	1.9	3.8	4.1
Exports	**3.4**	5.5	6.5	19.1	7.5
Imports	**-3.4**	-0.7	-1.4	4.3	-2.7
Deflator (YoY % change)	**2.3**	2.2	2.6	2.4	2.7

Trends

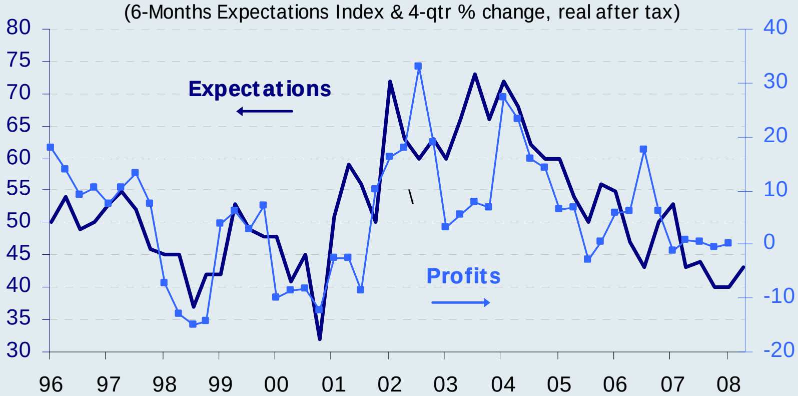
Nonfarm Payroll & Personal Consump. Expenditures
(Annual % Change & Real Annual % Change, 6MMA)



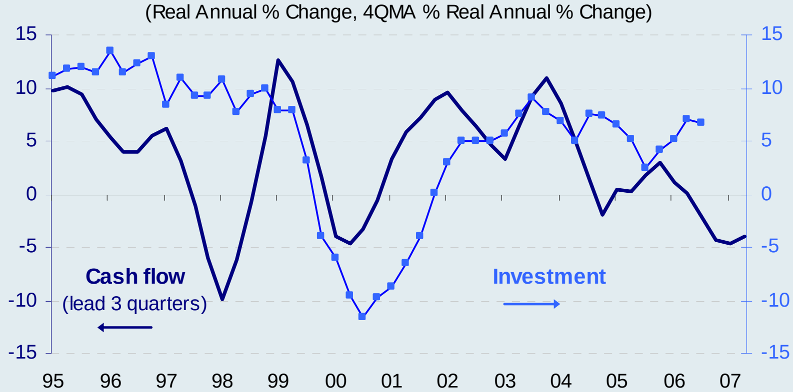
Nonfarm Productivity & Real Disposable Income
(Annual % Change, 4QMA)



Business Confidence & Corporate Profits
(6-Months Expectations Index & 4-qtr % change, real after tax)



Cash Flow & Non-Residential Investment
(Real Annual % Change, 4QMA % Real Annual % Change)



Personal Consumption Expenditures

In tandem with labor market's trend, PCE growth has moderated substantially since the end of 2007. We expect it to ease further in the next quarters as job creation and personal income continue to weaken. Real disposable personal income has moderated despite an upturn in productivity growth. Moreover, this productivity gains will not be enough to offset the current deceleration of employment –non farm payroll was unaltered on a year-to-year basis in June, while the unemployment rate has already reached 5.5%.

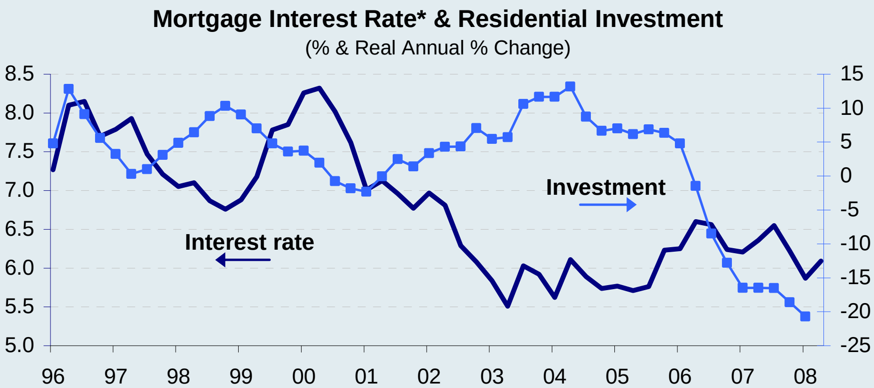
Risks to PCE are tilted to the downside. The financial turmoil has the potential to severely reduce credit supply. This could have a significant impact on demand for durable goods. In addition, turbulence in financial markets is taking its toll on stock markets, eroding the value of households' financial assets. This, together with falling home prices will hit overall households' wealth and thus, private spending.

Nonresidential investment

Non-residential investment will loose its momentum in the near future. Corporate profits after tax have flattened, while business confidence steadily declined to levels not seen since the recession of 2001. Cash flows fell 3.9% in 1Q08, posting their fourth consecutive decline.

According to Fed figures, the financing gap remained high at $258.9 billion in 3Q07; in a context of financial distress, this could a source of risks given that credit standards are tightening and that nonfarm nonfinancial corporate profits are decelerating.

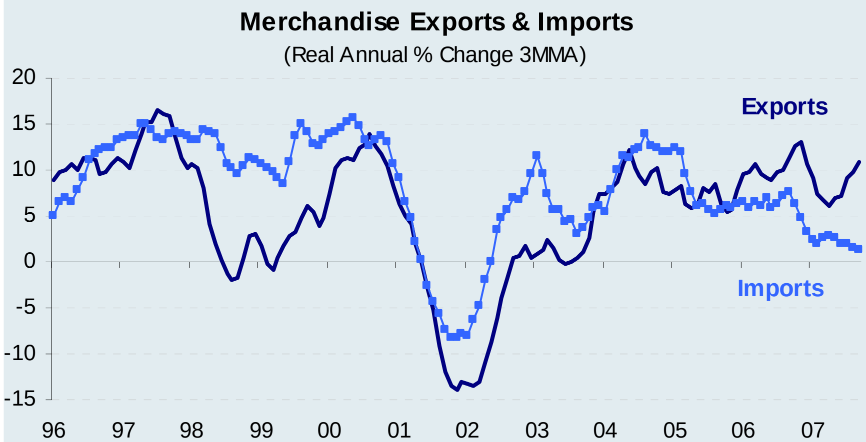
Declining corporate profits and cash flows together with credit scarcity could dampen capital spending plans. We expect a slowdown in business investment triggered by tighter credit conditions, slower sales, and the negative impact of the housing adjustment in some industries.



* Freddie Mac survey to 125 institutions; 30-year term with 20% down

Residential investment

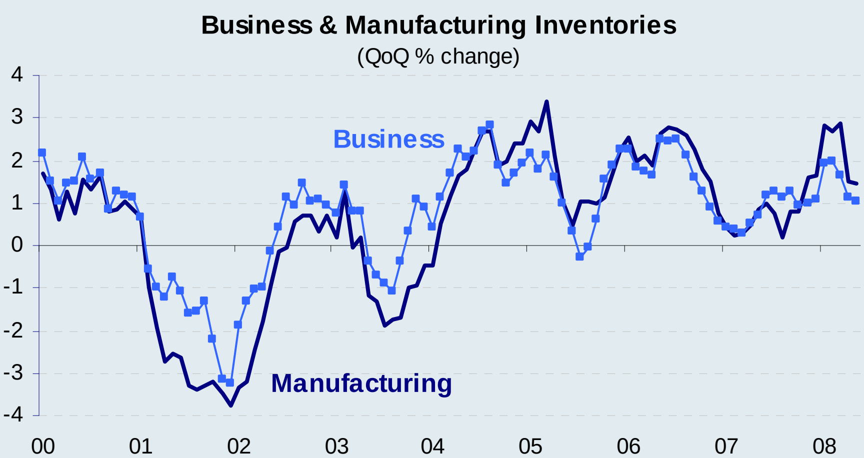
Problems in the housing and mortgages market have intensified; delinquencies and foreclosures are rising dramatically, while housing oversupply persists. As a result, the outlook for residential construction remains murky. For instance, the NAHB Housing Market Index fell to 16 in July, its lowest level on record. In 2Q08, housing starts fell 30.4%, averaging 1.02 million of annualized units, the lowest rate in seventeen years.



Net exports

Net exports have remained supportive of economic growth. In the first two months of the second quarter, real exports of goods expanded by an average of 10.2% year-on-year. In contrast, imports growth averaged -2.0% in the same period.

Going forward, U.S. trade with the rest of the world will be favored by sustained economic growth in major commercial partners together with a weak exchange rate. As a result, net exports will add to GDP growth in the next quarters.



Private inventories

Inventories likely subtracted to economic growth in the second quarter. Going forward, private inventories could decline further as firms scale back production to deal with a sluggish demand. However, we think that falling inventories may not be a major drag to GDP growth since inventories to sales ratios have are stable and historically low.

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