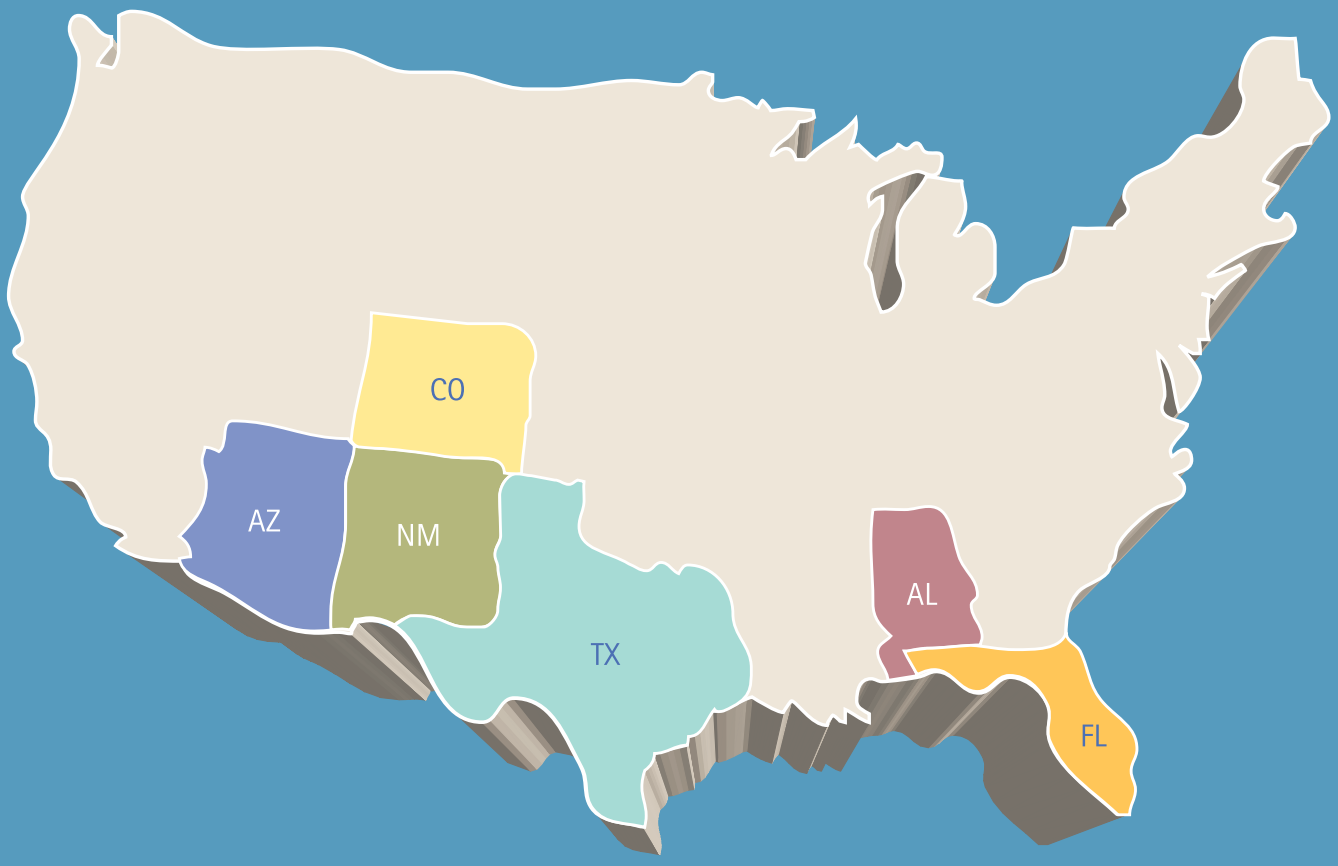
BBVA Compass

US Regional Watch

Economic Research Department

Fourth Quarter 2008



The US outlook turns for the worse:

- The economic outlook for the states in the BBVA Compass footprint deteriorates
- Texas: the impact of lower oil prices will be milder than in previous episodes
- Downside risks to the commercial real estate market
- Health Care challenges in the US: regional focus

Contents

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Fourth Quarter 2008

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Letter from the Chairman

We are pleased to bring you our second issue of the BBVA Compass U.S. Regional Watch. As a publication that focuses specifically on the Sunbelt, U.S. Regional Watch aims to provide a closer look at key issues that are impacting the economies in this region, while also placing them in a national and global context.

One of our core beliefs at BBVA is that our successes and those of our customers and communities are inextricably linked. This economic outlook publication is one of the ways we are taking the initiative to share information that can lead to the kind of thoughtful, smart decisions that will fuel our mutual success.

Given the current economic environment, a strong financial foundation has become more important than ever for companies seeking future growth—and at BBVA, we have been building such a foundation for over 150 years. In keeping with that effort, we have merged BBVA's four U.S. banks to create an organization that combines the best attributes of these local banks with those of the BBVA Group.

This combination of local and global strength presents some clear advantages for our customers. As a member of the BBVA Group, we can offer the strength and stability of being part of a global organization that is recognized as one of the strongest financial institutions in the world. BBVA Compass can also offer expanded options to help our customers meet the wide range of financial needs, delivered with service that focuses on building lasting relationships.

Today BBVA Compass is a regional banking leader with more than $61 billion in assets and nearly 600 branches across the Sunbelt—including Texas, Alabama, Arizona, New Mexico, Florida, and Colorado. As you'll see in this U.S. Regional Watch, these states have many economic strengths in common, yet their differences can be great, as well.

Our look at health care, for example, finds that regional differences are increasing, with the quality of outcomes varying significantly for states making similar expenditures. We also examine the recent decline in oil prices and what it may mean for short-term economic growth. These topics and others addressed in this issue will continue to be major concerns for businesses, and we hope you find these insights useful.

We always welcome the opportunity to share information that will help guide your business strategy and provide the financial services you need. Thank you for reading.

Sincerely,
Jose Maria Garcia Meyer
Chairman, BBVA Country Manager – U.S.

Editorial

As we go to press, the U.S. economy enters the second year of recession in an environment of elevated uncertainty regarding the depth and duration of the contraction. As a result of the sharp deterioration in both the financial markets and domestic demand since September 2008, we have revised downward our 2009 GDP growth forecast. At the regional level, economic activity has also weakened significantly in most states within the BBVA Compass footprint and thus, the outlook for those states has also worsened.

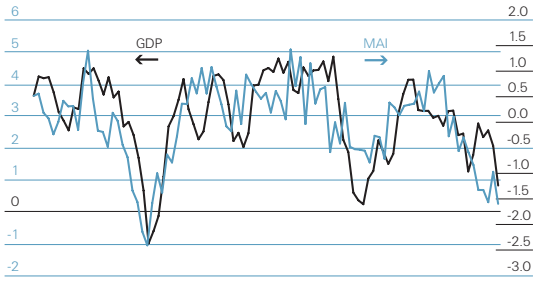
Our outlook for Texas has also been revised downward to take into account the impact of Hurricane Ike in 2008 and lower oil prices expected in coming quarters. In this issue, we provide two analyses that help us to understand both of these developments. The effects of Ike can be seen as a temporary negative shock, with a significant impact on overall economic activity; it will have a large effect on the mining sector and thus, on GDP. Nonetheless, during the recovery phase, non-residential and residential investment are likely to edge upward. Therefore, the short-term losses caused by the disruption of Ike will be partially compensated by stronger activity in following months. Our estimates suggest that the net impact on GDP will be around $11billion, equivalent to 1.0% of GDP.

The impact of lower oil prices on the Texas economy is likely to be significant, mainly in the form of lower employment and lower tax revenues. However, our analysis suggests that the effects are likely to be smaller than in previous periods of sharp price corrections given the lower dependency of the local economy on the oil industry. According to our estimates, a correction of $10 in average oil prices reduces state GDP growth by 0.1 percentage points.

Of greater concern is the deterioration of the commercial real estate market, caused in part by the deepening credit crunch. In this issue, we provide an analysis which highlights recent trends and the main risks going forward, particularly higher vacancy rates and lower returns. It is important to consider that risks are asymmetric; and thus, while some states face significant challenges, others like Texas, Colorado and Alabama, are better positioned to withstand the crisis.

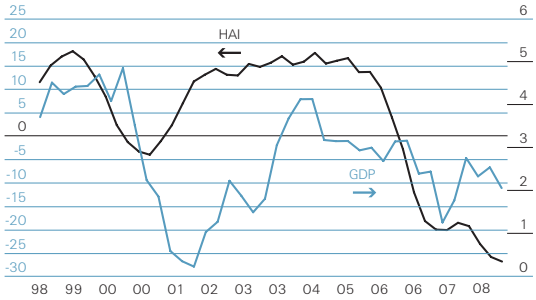
In this issue we also include an analysis on major metro areas. While official data is lagging other indicators, it is useful to grasp a clear and structural perspective to determine strengths and weaknesses within our footprint. With the same spirit, we provide the main results of a recent study aimed at ranking the 50 states based upon short- and long-term indicators, which can help determine those states most likely to register a faster recovery and higher growth rates over the long-run. According to our results, Texas, California, Washington and North Carolina are among the highest ranked states. Finally, we include a regional approach to health care that compares several indicators within our Sunbelt states.

BBVA Monthly Activity Index & GDP
Quarterly average & 4Q % change



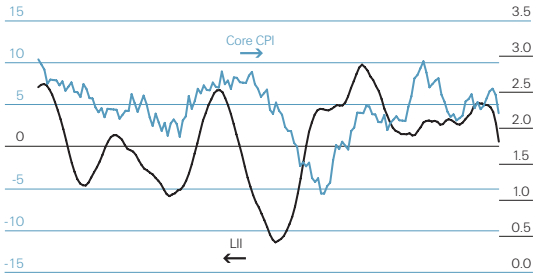
Source: BBVA and BEA

BBVA Housing Activity Index & GDP
4-Qtr % change



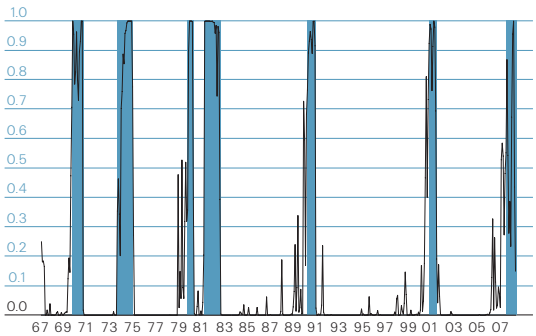
Source: BBVA and BEA

BBVA Leading Inflation Index & CPI Core
12-month % change



Source: BBVA and BLS

Probability of Recession
(%)



Source: BBVA
Recession in shaded areas

Over the past three months, the current financial crisis has outgrown the US and other developed countries and gone global. Since the bankruptcy of Lehman Brothers in September 2008, the distortions in global financial markets have become dire, as risk aversion reached extreme levels, liquidity tensions increased significantly, and economic growth strongly declined. In the short term, despite recent improvements in liquidity, there is little protection from the economic malaise around the world. The G3 (U.S., Japan & Europe) will contract in 2009 at rates of close to -1%.

In the US, the economic recession officially began in December 2007. In the first part of 2008, the economic pain was not reflected in aggregate production numbers, as external demand compensated for strong deterioration in residential investment, consumption and non-residential investment. In the last part of the year, however, the economic downturn entered a new and dangerous path.

On the one hand, the economic situation worsened. Housing prices have yet to find a bottom, external demand began to falter as growth slowed (and in some cases ground to a halt) around the world, and consumers in the US stopped spending. The prospects of lower demand and the expectation of a deep economic downturn have, in turn, created sharp employment declines. Consumers have curtailed spending, in a context where families have lost much of their wealth, many face credit constraints, and others are structurally changing their spending patterns to save more.

On the other hand, financial institutions have constrained credit as a negative feedback loop is feeding from economic growth to financial institutions balance sheets. It's in this environment that federal authorities are reacting fast with measures that range from assistance to homeowners, to fiscal stimulus and injecting public capital in the banking system. The central bank has reduced interest rates to record lows, and it is fast expanding its balance sheet.

Counting on fiscal stimulus, we expect the US economy to grow 1.4% in 2008 and -0.8% in 2009, although there is a significant degree of uncertainty depending on the fiscal stimulus package that is finally approved. At present, the steps taken by the government have avoided worst-case scenarios, but are not enough to guarantee a recovery in 2009. We would expect a recovery to take place in late 2009 and 2010 if additional fiscal measures are taken. The current situation calls for new fiscal stimulus in the US and elsewhere, and pursuing further monetary policy actions, using non-standard measures to increase the size and scope of the quantitative easing.

Inflation will hardly stand in the way. The CPI will turn negative next year, as lower commodity prices and the economic slack will push prices down. Core inflation will settle below 1% on average in 2009. While this could raise the specter of deflation, we believe the risk is still small, especially as the Fed travels the road of quantitative easing. While this road has its own perils, it is the best option, especially if it finances a fiscal stimulus.

Regional Outlook

Alabama

Economic recession will hit harder in Alabama than average

Alabama's economy deteriorated in the second half of 2008: employment growth was into negative ground, unemployment rate was highest in the last five years and house price appreciation was below inflation. Building activity decreased significantly and the economic activity indexes showed a descending trend. Strong exports growth and positive personal income gains have limited the economic slowdown.

In 2008, Alabama's economy is growing below its long-term trend. Nevertheless, deceleration has been milder than in previous recession episodes. The BBVA State Monthly Activity Index (SMAI-Alabama) has been persistently on negative territory since April 2008, accelerating its downfall in the third quarter. Going forward, the SMAI is likely to fall further, as manufacturing and housing continue to adjust downwards. Consequently, GDP will experience modest growth in 2008, around 0.9%, according to our forecast; and a 1.1% contraction in 2009, as a consequence of lower household consumption and lower investment, not only residential, but also non-residential.

The Philadelphia Fed State Coincident Index (PFCI) also shows a sharp economic slowdown, which started at the end of 2005 and worsened since the third quarter of 2007. The latest data also suggest that economic contraction began in mid-2008.

Job destruction should lead to weaker household consumption and lower residential investment

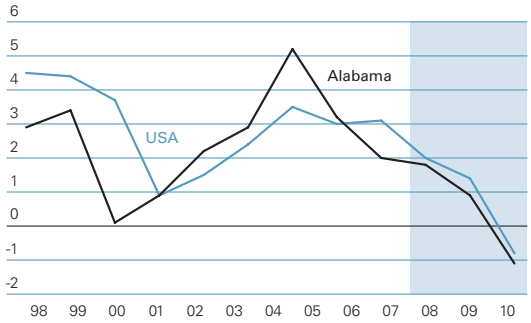
In October 2008, total non-farm employment decreased -0.1% year-over-year (yoy), the first negative rate since December 2003. Destruction of employment was significant in the manufacturing sector, with -3.3% yearly growth rate, and construction, which decreased -13%, while the services sector created new jobs, 0.6%, especially in government which increased 1.3%, and the professional and business services, which expanded 2%. The unemployment rate was 5.6%, the highest in the last five years. Things will get worse. In 2009, lower economic activity will imply a decrease in the employment level with the destruction of 20,000 additional jobs.

In this environment, in 2009, residential investment will fall further as building activity continues to decelerate. In fact, in 3Q08 housing sales dropped 28.5% yoy while building permits declined around 40%. Although housing prices are still appreciating, their pace was below inflation. Our forecast indicates that by the end of 2009, housing prices will decline by an average rate of 2.5%.

Exports are re-gaining ground while personal income growth remained above the national average

On the positive side, in 3Q08 state exports improved significantly as they increased 18.4% yoy. Minerals, energy and primary metal manufacturing were the most dynamic sectors in foreign markets. Exports of transportation equipment, which accounted for 35% of total exports, remained stable in 3Q08.

GDP Growth
Constant. Variation YoY (%)

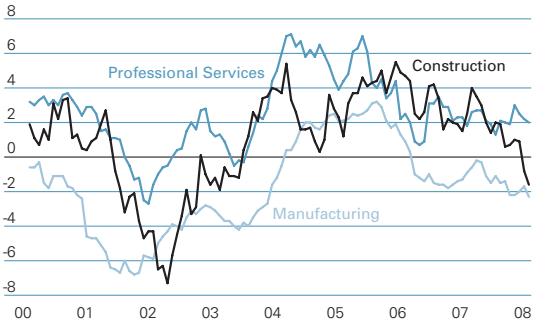


Source: BEA and BBVA ERD

BBVA Compass Alabama Monthly Activity Index
(3mma)

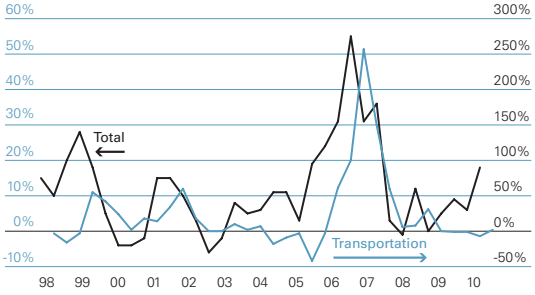
Source: BBVA ERD

Employment
YoY variation (%)



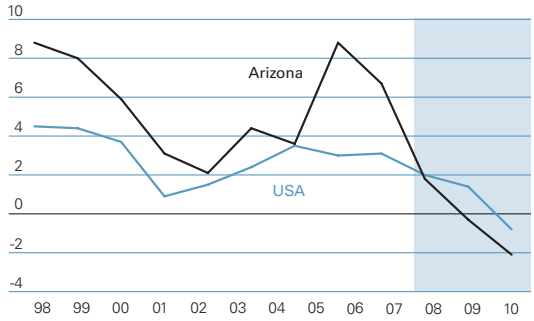
Source: BLS

State Exports
Variation YoY (%)



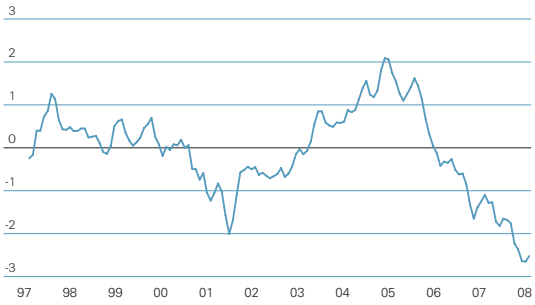
Source: Census

GDP Growth
Constant. Variation YoY (%)



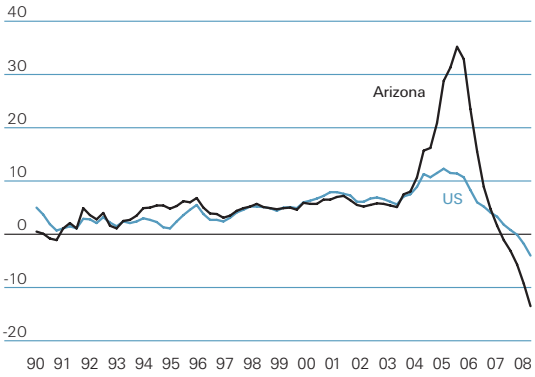
Source: BEA and BBVA ERD

BBVA Compass Arizona
Monthly Activity Index
(3mma)



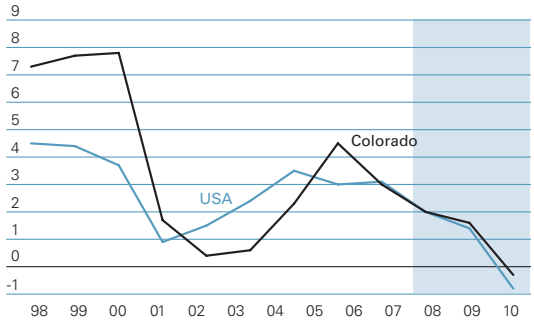
Source: BBVA ERD

Housing Prices
Variation YoY (%)



Source: OFHEO

GDP Growth
Constant. Variation YoY (%)



Source: BEA and BBVA ERD

Given the above, personal income growth—in real terms—remained positive through 2008 and averaged 5.0% in the three first quarters, 0.7% higher than the national growth rate.

Arizona

Housing meltdown is expanding into the state's economic system

In the second half of 2008, Arizona had a poor economic performance,with employment destruction, a rising unemployment rate and further housing market deterioration. Exports underperformed the national average and all activity indexes showed a deeper weakening. In fact, the BBVA SMAI for Arizona continued to decelerate, and it is currently moving below 2001-2002 levels, when the last economic slowdown occurred. The negative evolution of the index was the result of significant deterioration of the labor market and the ongoing housing adjustment. The trend depicted by the SMAI suggests that Arizona's economy will contract both in 2008 and 2009. Our forecast indicates that GDP will decline -0.3% in 2008 and -2.1% in 2009.

The PFCI indicates a decreasing trend for economic activity too. This slowdown is having a visible negative effect on employment: for the 12 month period ending in October 2008, more than 70,000 jobs were lost statewide (-2.6% yoy): half in the construction sector and the other half in manufacturing and services. Meanwhile, education, government and natural resources grew in 2008. In 2009, this trend will continue and about 70,000 extra jobs could be lost, showing a yoy decline of -2.5%. The unemployment rate in October 2008 jumped to 6.1%, the highest rate since November 2002.

As a result, the state's personal income is weakening, showing an increase below inflation in 3Q08. On average, personal income grew 3.3% in the first three quarters of 2008, one percentage point below the national average. This trend suggests further deterioration in 2009, which will limit household consumption.

Housing continues dragging down the economy

Despite the recent rally in existing home sales, the local housing market slowdown has been intense; with a deeper adjustment in building construction and new home sales and further home price depreciation. Sales of foreclosed homes increased significantly in 3Q08 helping quarterly existing home sales figures to rise to 141,000 units, 28% above 2Q08. However, the lack of demand for new houses is affecting new building projects, which dropped more than 44% in 3Q08 in relation to a year earlier, while housing prices, descended 13.5% yoy. Housing prices will continue to decline in 2009 as employment weakens further.

Colorado

State's economy is proving to be resilient

Colorado's economy performed above the national average through 2008, with positive employment growth and significant personal income gains. In 3Q08, exports grew intensively while the housing market curbed down. However, home prices declined for the first time since the late eighties and its trend indicates further depreciation in 2009.

Colorado's BBVA SMAI suggests that the economy remains slightly below its long-term trend. This is consistent with positive GDP growth figures for 2008 and a short correction in 2009. Our forecast indicates real growth rates of 1.6% for the former and -0.3% for the latter.

In line with the above, the PFCI is also reflecting a gradual slowdown since 4Q07, although it remained positive through 2008. As a consequence of lower economic activity, the employment growth rate is diminishing, but it is still positive. In 2008, job creation in the services industry, especially education, government and leisure, helped to mitigate losses in construction and manufacturing industries. Although the unemployment rate stood at 5.7% in October 2008, it is still one percentage point below the national average. In this context, personal income rose notably, averaging 5.4% in the first three quarters of 2008, more than one percentage point above the US average.

Exports yoy growth increased gradually in 2008 from 0% in 1Q08 to 18.9% in 3Q08. Expansion of mineral and oil-related items, transportation equipment and processed food facilitated this positive trend. Nonetheless, the long-term trend shows a declining relative share of the state's exports in relation to national figures.

Housing market still under pressure

In 3Q08, average home prices fell -0.3% yoy and its trend points to further depreciations. Although Colorado's residential investment and building activity slowdown was lighter than national average, there are still significant risks in some local markets that will limit short-term economic recovery.

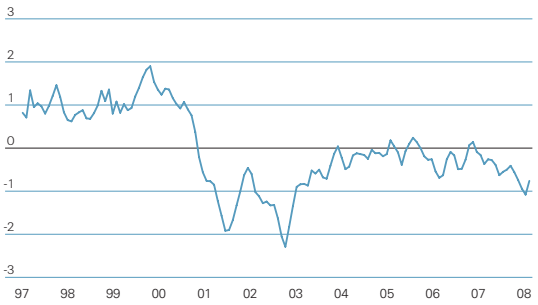
Florida

Housing slowdown brought the first economic recession since the seventies

Florida is experiencing the sharpest recession in history according to the different activity indexes, which have fallen to their lowest levels on record. Recession has been caused by a severe adjustment in the housing market. Non-farm employment yearly growth rates are negative since September 2007 and personal income grew below inflation in the first three quarters of 2008. After the economy stagnated in 2007, our forecast indicates that real GDP will decline -0.9% in 2008 and -1.7% in 2009.

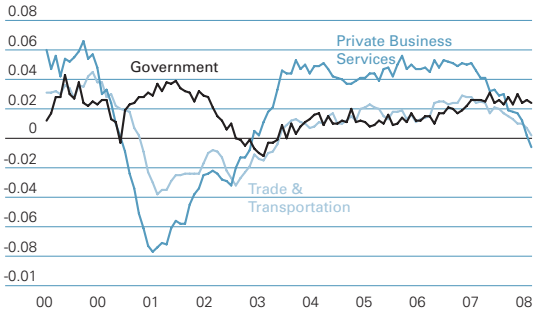
In the second half of 2008, both the BBVA SMAI and PFCI are at their lowest values registered since the state's data has been collected. Construction activity is paralyzed, especially in the residential segment, and manufacture industry production is seriously declining. In addition, the services sector began to shed jobs since the summer of

BBVA Compass Colorado
Monthly Activity Index
(3mma)



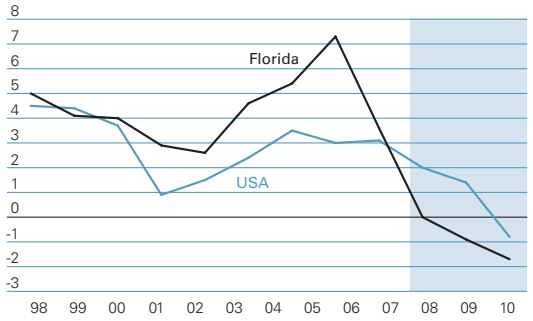
Source: BBVA ERD

Employment
YoY variation (%)



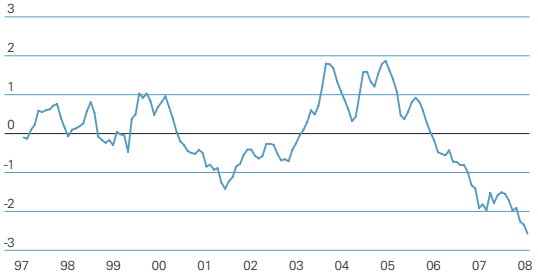
Source: BLS

GDP Growth
Constant. Variation YoY (%)



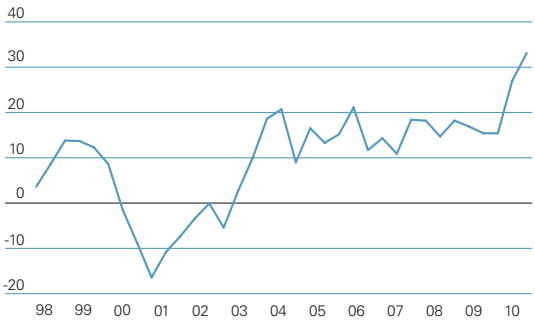
Source: BEA and BBVA ERD

BBVA Compass Florida
Monthly Activity Index
(3mma)



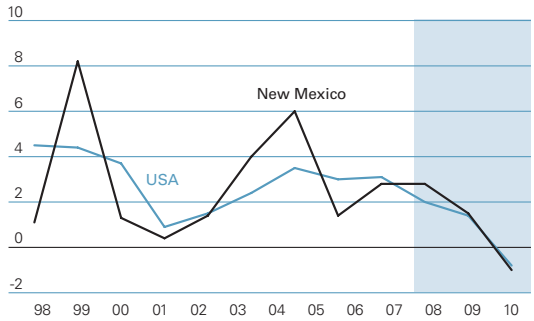
Source: BBVA ERD

State Exports
Variation YoY (%)



Source: Census

GDP Growth
Constant. Variation YoY (%)

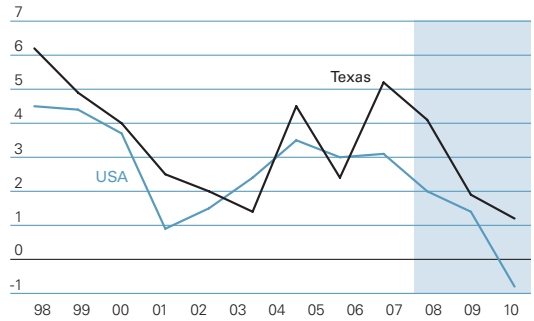


Source: BEA and BBVA ERD

BBVA Compass New Mexico Monthly Activity Index
(3mma)

Source: BBVA ERD

GDP Growth
Constant. Variation YoY (%)



Source: BEA and BBVA ERD

2008. The unemployment rate has increased, reaching 7% in October 2008, the highest rate since 4Q93.

In 3Q08, personal income rose 2.1%, the lowest nominal rate since the early seventies. Florida personal income is growing below inflation levels since 4Q07, which is negatively affecting households' consumption and residential investment.

Although current housing slowdown is truly deep, the strong house price correction would help local housing market to anticipate national recovery. Growing exports will support economic upturn

Following preceding trends, in the second half of 2008, home sales and building activity dropped significantly while residential prices depreciated further. Although existing home sales improved slightly in 3Q08 in relation to previous quarters, due to the large number of homes in foreclosure that were auctioned, demand is still weak and building activity remains low. In the second half of 2008, housing prices continued depreciating and 3Q08 levels were 35% below the maximum observed in 4Q06. Further housing price adjustments will likely boost demand.

The weak dollar is strongly supporting Florida's exports, which grew 33.1% yoy in 3Q08 and are increasing their national share. This reflects strong increases in transportation equipment, machinery, primary metals manufacturing and chemicals. If these trends were to continue, exports could be significant for an eventual recovery due to the higher value added from these industries.

New Mexico

Lower commodity prices is damaging local activity

In the second half of 2008, non-farm employment remained stable and unemployment rates stayed low, while personal income grew well above national average. However, activity indexes show a gradual economic deterioration that could lead to a recession in 2009. The economy is transiting through a period of subpar growth. However, current deceleration still seems milder than in previous episodes. Our forecast indicates a similar growth rate to the national average in 2008, around 1.5% in real terms, but lower in 2009, -1.0%. That is consistent with the BBVA SMAI, which shows that current evolution is below the long-term trend, suggesting a further correction in 2009.

Non-farm employment remained stable through 2008, but trends indicate further deterioration. Not only manufacturing, but also employment in the construction industry, had negative growth rates in 3Q08. Employment growth in services was supported by gains in education and government, which together account for almost 38% of the state non-farm payroll.

In 2008, exports remained weak, as commodity prices slowed down, and residential investment decreased in line with national average. Although in 3Q08, housing prices showed a negative yoy variation for the first time since 4Q99, demand remained weak and housing sales are still negative.

Texas

Economic growth will remain positive although at lower rates

In 2008, although still in positive ground, the state's economic growth rate moderated significantly. The national slowdown, the hurricane's impact and lower energy prices negatively affected the state's economic performance. Although the BBVA SMAI suggests that Texas' economy is moving around its long-term path, it moderated appreciably in the second half of 2008. We expect the economy to decelerate somewhat, but to keep a sustained pace of growth, compared with other southern states. Our forecast indicates a growth rate below 2% in 2008 and around 1.2% in 2009.

The PFCI index is also slowing down since mid 2007, but remains positive. Lower economic growth is already affecting the labor market, with lower employment growth and higher unemployment rates. In October 2008, non-farm employment rose 2.2%, with positive increments not only in the services industry, but also in the construction sector. In the manufacturing industry, employment has been gradually declining since the beginning of 2008, but at lower rates than the national average. In October 2008, the unemployment rate was 5.6%, 15 percentage points above a year earlier.

In 3Q08, the state's personal income rose 6.1%, almost double the national average. Throughout 2008, personal income increased 6.7%, which helped to sustain household consumption and limited the negative impact of the housing meltdown.

However, despite the slowdown in residential investment, employment growth in the construction sector remained positive in 2008 due to solid commercial real estate investment and infrastructures' construction development. Home sales dropped 15% in the first three quarters of 2008, while residential building activity decreased 25% on average during the first ten months of 2008. Home prices are still appreciating in most markets, although at lower rates than in previous quarters.

Exports have shown significant strength and will limit economic downturn

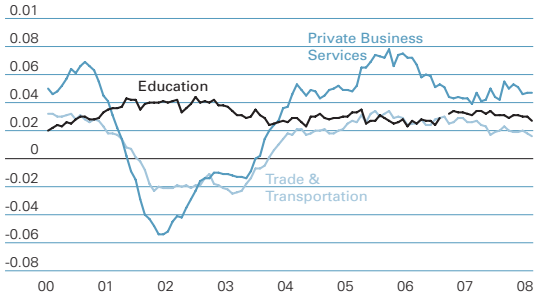
Exports have been growing above the national average since the beginning of the current decade, increasing the relative share of total US exports. Energy, primary metals and agricultural products were the key factor for the exports' expansion in 2008. The global slowdown is likely to result in a weaker demand for exports and thus, the positive impact on economic activity during 2008 is likely to be significantly lower in 2009. Nonetheless, it should continue to provide some relief for certain industries and help to contain the economic slowdown.

Therefore, the biggest risks for the Texas economy in the next two years are a sharper contraction in the rest of the country, declining oil prices, and a major downward adjustment in foreign trade.

BBVA Compass Texas Monthly Activity Index
(3mma)

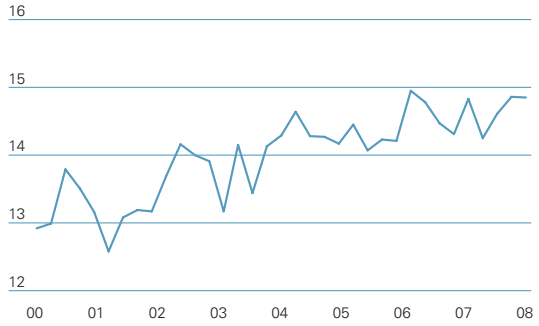
Source: BBVA ERD

Employment
YoY variation (%)



Source: BLS

Texas Exports
As % of Total US



Source: Census and BBVA ERD

Oil Forecast

Crude oil prices: how low can they go?

A sharp downward momentum has been operating in the oil market since mid July 2008. After reaching an all time high of $147 per/bbl, Brent futures approached $40 per/bbl in December, a bottom line which had last been crossed in 2004.

The main driver for the slump has been the global financial crisis and the ever-worsening economic outlook. For the first time since World War II, the US, Japan and Europe are in (or close to) recession and, concerns that it could also hit the emerging world are mounting. We expect that the global oil demand will experience its first contraction in 25 years and most probably will decrease during 2009, too.

Thus far, the oil market sentiment has turned increasingly reactive to bad news from the demand side, and any attempt by OPEC to stop the free fall in prices has proven ineffective—even though cuts announced in the last four months amount to a staggering 4.2 million barrels a day (mbd). On the day of the last cut announcement by OPEC, Russia and Azerbaijan signaled that they would make an additional 0.6 mbd cut next year if prices remained low. Interestingly, the Brent futures closed the day with a 4% drop.

Looking to the future, in the very short term, the main determinant of prices will continue to be the evolution of the global economy. However, it is likely that supply factors may start affecting the mood of the market in the next several months.

Main determinants for future prices: demand

Both the International Energy Agency (IEA) and the US Energy Information Agency (EIA) have revised downward their global oil demand forecasts several times since this summer. As of mid December, they expect a negative growth rate around -0.1%, -0.2% in 2008, whereas for 2009 the IEA predicts a 0.4% recovery and the EIA a 0.5% drop.

These forecasts are based upon a big contraction of oil demand in the OECD countries, especially in the US, where demand is poised to decrease by more than 5% in 2008 and by more than 2% in 2009. While oil demand in most non-OECD economies will exhibit positive growth rates, they will tend to be clearly lower than those observed in the last years.

Main determinants for future prices: supply

OPEC's movements will be decisive, as it supplies 40% of the global oil market. The last announcement made by OPEC on December 17, of a 2.2. mbd cut in the production target, to be effective from January 1, 2009, puts the total production cuts agreed within the cartel since September, to a staggering 4.2 mbd. However, all efforts made have clearly failed in their objective to anchor up market expectations.

The two main reasons behind this are the high level of global inventories and a general skepticism about whether the cuts will be made effective or not (until November, the average level of compliance observed was about 60%). With a sufficiently high level of compliance rate (over 85%), though, over 3.5 mbd would be withdrawn from the global oil market. This should be enough to reverse the downward trend in oil prices unless the world economy contracts even faster (a possibility that cannot be ruled out).

The key now is whether OPEC will be able to enforce such a high compliance rate among its members. The heterogeneous nature of the organization (whose members face different economic, political and social challenges), together with the lack of any monitoring and punishment mechanisms to detect and/or deter non-compliance, makes the cartel vulnerable especially when prices are falling. With a weak global oil demand and surplus capacity, the incentives for non-compliance have been strong until now.

However, protracted non-compliance exacerbates the risk to enter a spiral of ever decreasing oil prices and revenues. Contrary to the past experience, there is evidence that the "scarcity rent" concept may now be playing a more significant role in the decision-making process of key oil countries[1]. This implies that, with prices below a certain threshold, the optimal strategy of oil producers might be leaving the oil in the ground and waiting until the price rebounds.

Oil revenues constitute the main source of income for all OPEC members. Their governments need high oil revenues to balance their economies and future budgets, and an oil price in the forties is well below the break-even fiscal price of most of them[2].

1 See Hamilton, James D. 2008. "Understanding crude oil prices", Working Paper 14492, NBER.
2 OPEC gets, on average, 10 dollars per barrel less than Brent.
3 Stripper wells are small wells that are close to the end of their economical useful life. They produce 1.3 mbd (18% of the onshore US production).
4 Estimate given by the IEA in its last update of the Mid Term Oil Market Report.

Oil Forecast

According to the IMF, OPEC as a whole could cope quite well with an international price around $50 per barrel. However, while Saudi Arabia's break-even fiscal price lies quite close to the $50 per bbl average, other big producers, like Iran or Venezuela, would need to get a price above $80 per bbl to balance their fiscal budgets. As for Russia, its Finance Minister has declared that the budget would break even in 2009 at a price of $70 a barrel.

Beyond fiscal balances, the oil industry has identified sustained prices of $50 per bbl as a threshold below which investment decisions could be stopped. OPEC current prices are well below the marginal cost for most new oil projects ($70 per bbl) and close to the production costs of existing conventional projects ($20-40 per bbl). Many of the "stripper" wells operating in the US are no longer profitable[3].

All in all, in a context of excess supply, these determinants will not be binding. However, if during 2009 OPEC gets to implement the agreed cuts to a large extent, they might start playing a role. Most likely, once the global economy recovers and oil demand rebounds, higher prices will be needed to reconcile demand and available supply. While lower oil prices have been warmly welcomed by all consuming countries, the risk that they could throttle oil investment should not be underestimated.

Taking a 1.2% average annual growth rate for the global oil demand between 2009 and 2013[4], and an annual natural decline rate for the production by mature fields equal to 4.5%, we estimate for supply to balance demand, new projects would have to add new gross capacity at an annual rate of 5.7% (equivalent to 5 mbd per year).

However, according to available information on new projects this may only be possible for the next two to three years[5]. In the absence of significant geopolitical disruptions to petroleum supply, the expected drop in demand and the new production capacity already added should grant a sufficient level of supply until 2011. But, beyond 2011, when a scenario of full economic recovery is expected, unless new big projects are brought on line on time, demand could easily exceed supply, and, as a result, high and escalating oil prices would be needed to reconcile the global oil balance.

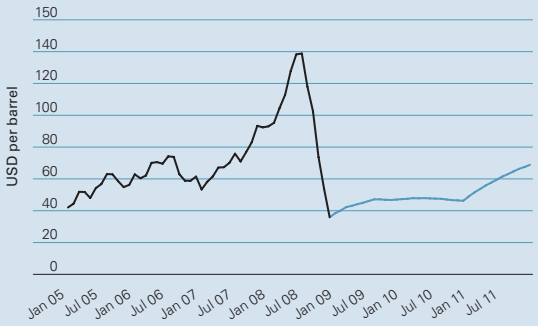
Our forecasts point towards price stabilization

Our forecasts for the oil price take into account the fundamentals of demand and supply that were revised in the previous section plus expectations over a stronger dollar and declining levels of oil product inventories at the global level (which at present are well above historical levels).

We think that, during 2009 (and probably 2010 too), reduced demand and financial concerns will continue to put pressure on oil prices which is unlikely to be fully neutralized by supply restrictions.

In line with our expectations over the economic conditions and the likely downward reaction of the supply[6], our central scenario foresees oil prices to bottom around 40 USD/bbl at the beginning of next year and then to follow a trend of smooth recovery along the year, as supply pressures start playing their role. We forecast an average price of 46 USD/bbl in 2009 and of 49 USD/bbl in 2010 with a more balanced supply and demand. In 2011, once the economic recovery path is fully established, we expect oil prices to average 61 USD/bbl, ending the year at 70USD/bbl.

Monthly Oil Change:
observed prices and BBVA forecasts



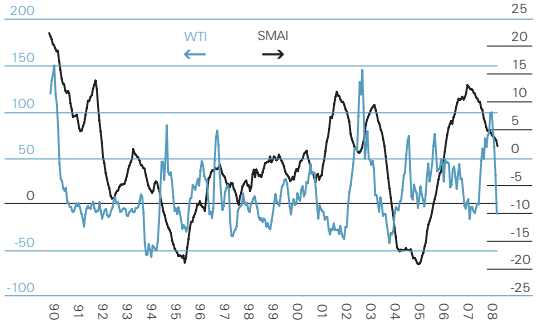
Source: Bloomberg and BBVA ERD

Although we do not discard a temporary drop in prices (even below 30 USD/bbl) during 2009, especially if the global recession extends to China (which we do not expect), we believe that this scenario should not be considered as central because there is a significant probability that, at such low prices, supply pressures would reinforce (non OPEC producers may find it profitable to shut down certain facilities while those within OPEC would find it increasingly beneficial to stick to their quotas or even approve further cuts).

5 See "The Oil Crunch: Securing the UK's energy future". 2008. The UK Industry Taskforce on Peak Oil & Energy Security (ITPOES) and http://en.wikipedia.org/wiki/Oil_megaprojects.

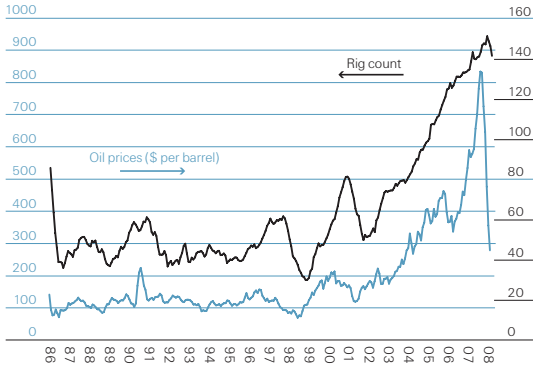
6 We estimate that the US economy will be growing by -0,8% and 1.1% during 2009 and 2010 respectively whereas China would grow by 8,1% and 8,4%.

Texas: State Monthly Activity Index & Oil Prices (YoY % per barrel)



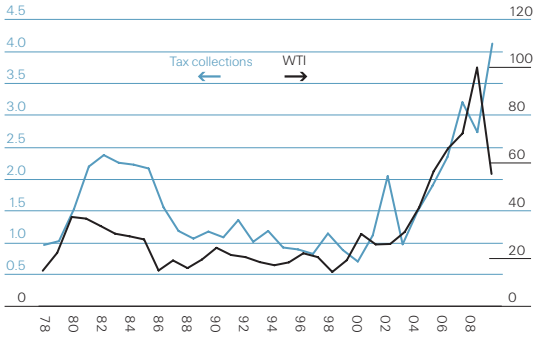
Source: BBVA and Federal Reserve Bank of Dallas

Rotary Rig Count & WTI Oil Prices



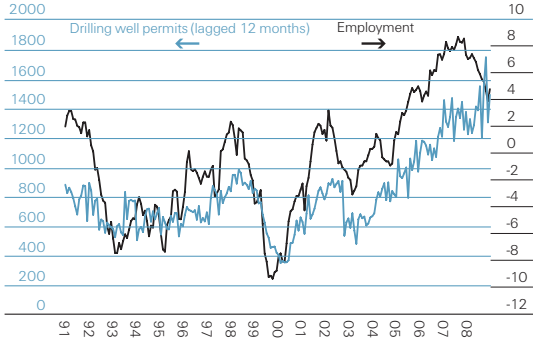
Source: Baker Huges and Federal Reserve Bank of Dallas

Tax collections from oil & gas production & oil prices ($bn & dollars per barrel)



Source: Texas Office of the Comptroller of Public Accounts and Federal Reserve Bank of Dallas

Employment in oil & gas extraction & drilling well permits application



Source: BLS and Texas Railroad Commission

The Impact of Oil Prices in Texas Economy

Since mid 2008, oil prices have declined rapidly from $145 per barrel on July 14th to $40 in December. Overall, the U.S. economy will benefit from lower energy prices: consumers will spend a larger share of their income on goods and services, while firms will probably face lower production costs; transportation costs will also decline, supporting exports and tourism. But not everyone gains the same when energy prices drop. At the regional level, state economies respond differently to changes in oil prices. The economy of Texas benefits when oil prices go up and suffers when they go down.

Texas remains the leading producer of oil and gas in the U.S., accounting for about 20% of the country's total production. Not surprisingly, a significant share of Texas' Gross Domestic Product (GDP) is due to the energy sector. For instance, between 1996 and 2007, oil and gas extraction averaged 5.3% of Texas real GDP versus 0.8% for the U.S. as a whole. Likewise, in 2007 oil and gas extraction accounted for 0.7% of total non-farm payroll versus 0.1% in the U.S. The impact of changes in energy prices is not limited to oil and gas extraction. Many different services are connected to the energy industry, including residential and commercial real estate activity. There are three major channels through which falling oil prices are likely to hit the Texas' economy:

1) Oil and gas production

Changes in oil prices affect the profitability of active rigs and drilling projects. The number of rotary rigs increased from 323 in August 2002 to a peak of 943 in September 2008. This trend may be coming to an end. On a yoy basis, Texas' rotary rig count decreased 1.3% in December 2008, the lowest rate since January 2003. Thus, given the current downward trend in oil prices, a major reduction in the number of active rigs is likely to occur in the coming months. Drilling projects will not only be affected by lower oil prices, but also by credit constraints. For instance, tighter credit standards will deprive many companies of necessary funding to lease vast extensions of land. Therefore, several owners will not be able to cash out on their land. The combination of lower oil prices and financial distress will force firms to cut capital spending.

2) Employment

As the number of active rigs and drilling projects declines, so does employment. Along with rising energy prices, employment in oil and gas extraction increased rapidly—by an average year-to-year rate of 6% between January 2005 and October 2008. In the same period, oil and gas production accounted for 1.1% of total employment growth. According to our estimates, a reduction of 1000 drilling permits results in 7500 fewer jobs in the oil and gas extraction industry.

3) Tax collections

Tax revenues will also decline as a result of lower oil prices. This will have a negative effect on the amount of money devoted to public projects such as transportation, infrastructure, education, etc. In fiscal year 2008, 4.8% of total tax collections, about $4.1 billion, stemmed from oil and natural gas production. If we include gasoline taxes, this share increased to 8.4%. In FY 2008, tax collection from oil and natural

gas production increased by 72.1% and 41.6%, respectively from the previous year. Assuming 0.7% elasticity and the BBVA forecast of $46 per barrel, tax collections from oil production could decline as much as 40% in fiscal year 2009.

The impact of the current oil shock may be less severe

Using a simple vector auto regression model, we found that a $10 decline in the price of oil subtracts approximately 0.06 percentage points from Texas' GDP growth. Thus, assuming a forecast of $46 per barrel in 2009, the sharp drop in oil prices will subtract a bit over 2.2% from GDP growth in that year.

Although the impact of lower oil prices in Texas' economy will be significant, it will probably be less severe than in previous downturns. Indeed, the economy is now less vulnerable to energy fluctuations than it was 20 years ago. The share of oil and gas extraction in total GDP eased from a maximum of 18.9% in 1981 to 7.5% in 2007. Stephen P.A. Brown and Mine K. Yücel found that between 1970 and 1987 a larger percentage of economic fluctuations in Texas were explained by changes in oil prices than between 1988 and 2002. This was due in large part to diversification. Over the past 20 years, employment has moved away from the energy sector. Industries such as professional and business services, construction, education and health care have increased as a percentage of the labor market.

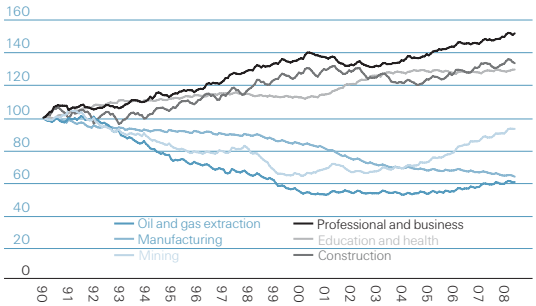
Additional factors should help Texas' economy weather the sharp decline in oil prices. One is the lack of a housing bubble. Home prices in Texas have not fallen as they have in other states, preventing household wealth from deteriorating sharply. This should give some support to consumer spending. Another factor is the source of oil price fluctuations. Contrary to previous oil shocks, the current downturn is driven by demand. This means that as long as the global recession continues, oil prices will drop further. Once recovery begins, however, oil prices will climb quickly in response to strong demand, particularly from emerging economies whose growth depends heavily on petroleum-intensive industries.

The Houston-Sugar Land Baytown area and oil prices

The Houston-Sugar Land-Baytown metro area will be affected by the downward trend in oil prices. According to BLS figures, from January 2007 to October 2008 employment in oil and gas extraction increased by a yoy average of 6.4%, while total employment rose 3.5%. Employment growth in oil and gas extraction outpaced even construction (5.7%) and private services (3.8%). Falling oil prices will drag down Houston's personal income, consumer spending and tax revenues. However, as in the rest of Texas, the extent of these effects could be less severe than in prior periods of falling oil prices, due in part to Houston's more diversified economy. In fact, sectors such as professional and business services, education and health care have increased their importance in the labor market. In addition, the region has not suffered the effects of the housing bubble, and export growth continues to generate activity in Houston's port, which is ranked second in the U.S. in total tonnage.[1]

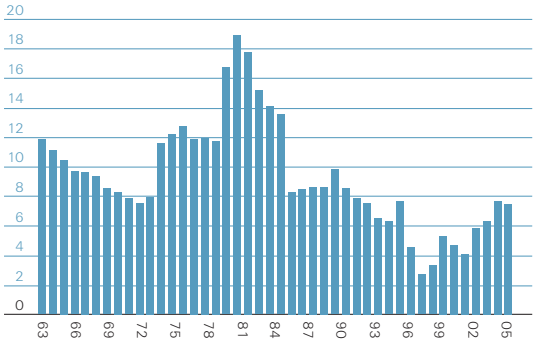
1 Brown, Stephen P. A. and Yücel, Mine K. Yücel (2004), *The Effect of High Oil Prices on Today's Texas Economy*, Federal Reserve Bank Of Dallas, Southwest Economy, Issue 5, September/October.

Share in non-farm payrool, Texas
(1990=100)



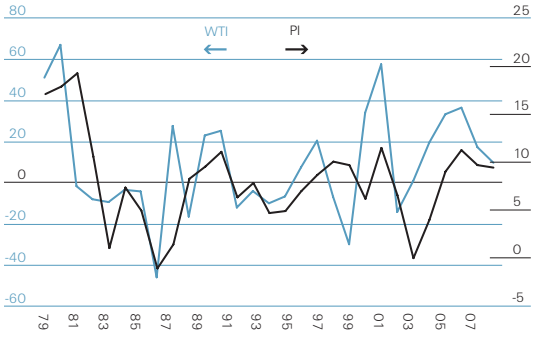
Source: BLS

Texas Oil & Gas Extraction
(Share of GDP)



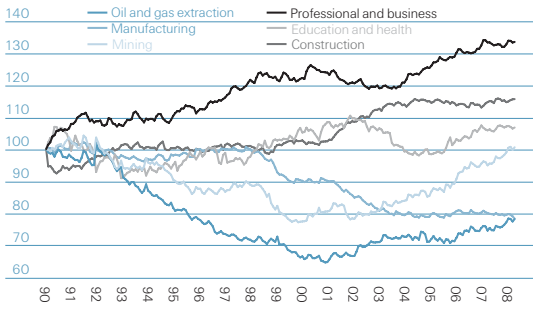
Source: BEA

Personal Income & Oil Prices, Houston-SugarLand-Baytown (YoY % change)



Source: BEA and Federal Reserve Bank of Dallas

Share in non-farm payroll, Houston-Sugar Land-Baytown (190=100)



Source: BLS

The total economic impact of Ike in Texas tops $19 billion

- Ike is the third-costliest hurricane in U.S. history
- Its negative effects could subtract up to 1% from Texas' 2008 GDP

Ike hit the Texas coast on September 12 as a category 2-3 hurricane. Its damages extended well over 200 miles inland from Galveston. Ike's net economic impact will be over $11 billion, which is equivalent to roughly 1% of the Texas GDP. The negative effects from Ike could also lead to a temporary loss of more than 125,000 jobs, as well as a moderation in state personal income during the fourth quarter of 2008. It seriously affected business and industries in Houston and surrounding towns.

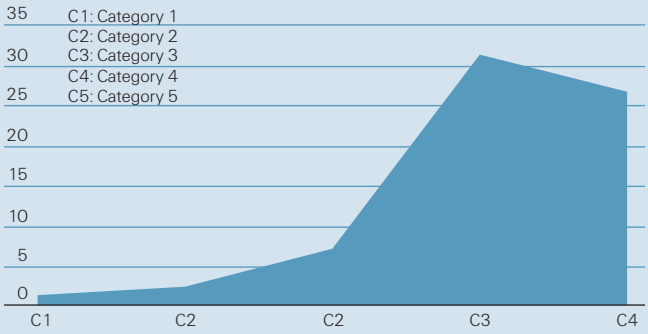
Ike negatively affected both the general economic activity and the oil industry previously impacted by Hurricane Gustav. The economic cost of closing businesses, factories and retail stores in the Texas coastal metro areas in the days following the hurricane will top $13.1 billion. The impact on the oil and gas industry will approach $3.5 billion, not only from the lack of production but also from the negative effects on pipeline transportation and refineries. Finally, the economic losses from damaged commercial buildings and other industrial infrastructure are estimated at $2.5 billion. The overall direct economic impact of hurricane Ike is estimated at $19.1 billion, making it the third-costliest hurricane in U.S. history. However, rebuilding will bring to the area new economic activity in subsequent quarters that could total $8 billion.

In general, the bigger the hurricane, the greater the economic damage. While the average damage from a category 1 hurricane is over $1.2 billion, the damage for a category 2 is $2.3 billion, and, for a category 4, damage rises to more than $32 billion. Since 1900, more than 150 hurricanes have had a significant economic impact on the states bordering the Atlantic coast and the Gulf of Mexico. When the data is normalized (1) — hurricane damage estimated under today's population and housing price assumptions — the average economic cost in 2008 dollars is more than $7.0 billion per hurricane, or over $10.3 billion a year. While this decade has been one of the most destructive and costliest — there is no statistical evidence that economic damage is rising through time.

Hurricane IKE Texas Economic Losses $ Billion	
Economic Production	13.1
Oil Industry	3.5
Infrastructure Damage	2.5
Total	19.1
Reconstruction Activity	8
Net Effect	11.1
% GDP	1.0%

Hurricane Damage

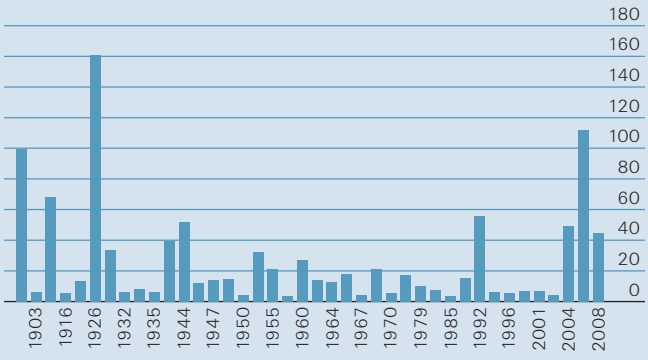
$ Billion by Hurricane Category



Source: BBVA ERD based on data from "Normalized Hurricane Damages in the United States: 1900-2005" Roger A. Pielke (et al)

Hurricane Economic Costs

Cost adjusted. $ billion 2008



Source: BBVA ERD based on data from "Normalized Hurricane Damages in the United States: 1900-2005" Roger A. Pielke (et al)

1 According to Roger A. Pielke, et al, (2006) "Normalized Hurricane Damages in the United States: 1900-2005".

MSA Analysis

Metro areas make up the backbone of US economy and they are more prepared to face the economic downturn.

Metro population figures increased in BBVA Compass' footprint; while relatively stable in the rest of the country

Population, employment and economic activity concentrate in America's metro areas. In 2007, 83.1% of the US population lived in the 363 existing Metropolitan Statistical Areas (MSA), which represented 86.2% of the country's total employment and 90.8% of non-agricultural jobs. In the current decade, GDP generated in all of the MSAs accounted for 91% of total GDP.

Within BBVA Compass' footprint, metropolitan areas have even deeper economic relevance. Within the footprint, 88.2% of the population lives in 72 MSAs accounting for 93% of total employment and 93% of total regional GDP. Metro population is higher in FL (94.1%), AZ (92.5%), TX (87.2) and CO (86.2%), but lower than the national average in AL (76.3%) and NM (66.0%).

The importance of metro areas in the US has increased over time. In the last 40 years, total MSA population has grown 1.15% a year, while total population in the country has grown 1.07%. Following this trend, total MSA population in 2030 will exceed 310 million people, representing almost 86% of the total US population. Metropolitan population growth in the BBVA Compass footprint has increased 2.4% a year in the last four decades, while only .9% in metropolitan areas in the rest of the country.

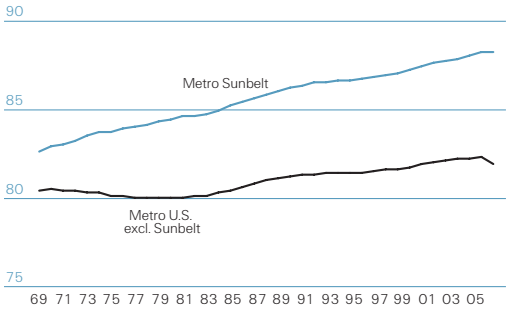
Higher productivity has driven higher economic growth in the Sunbelt's MSAs.

This population growth gap reflects the greater economic push of the Sunbelt's MSAs. In fact, BEA data shows that the Sunbelt 72 MSAs had an average real GDP growth of 3.7% between 2001 to 2006, while the remaining 291 US MSAs grew by 2.7%. In the same period, the employment gap was 1% higher in the MSAs of Compass' footprint.

In some of the Sunbelt's metro areas, however, the significant impact of the housing downturn and the current economic slowdown suggest a milder economic growth in the short term. Our metro GDP forecast points to similar growth rates in 2007 in the region's MSAs and the remainder of the country, but lower growth rates for BBVA Compass' MSAs in 2008 and 2009.

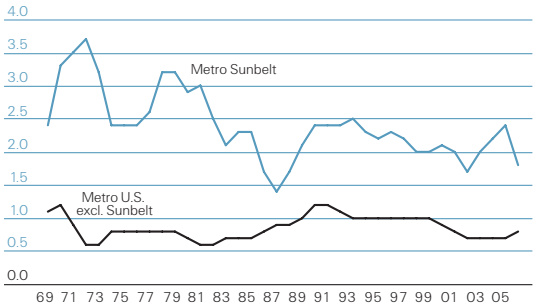
Higher productivity growth has been the key driver of the economic growth gap in favor of the metro areas in BBVA Compass' footprint. Although growth rates are broadly similar at present, labor productivity in BBVA Compass' MSAs has been historically higher than the national average. In the present decade, productivity levels are about 10% higher in the Sunbelt's MSA compared to other MSAs.

Metro Population
As (%) of Total



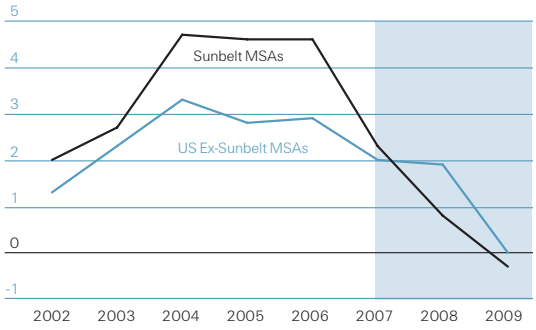
Source: Census and BBVA ERD

Population
YoY Change (%)



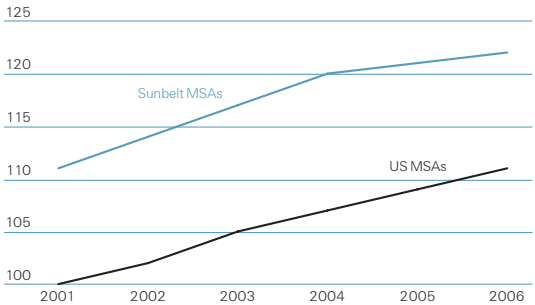
Source: Census and BBVA ERD

Metro Statistical Areas' GDP
YoY variation (%)



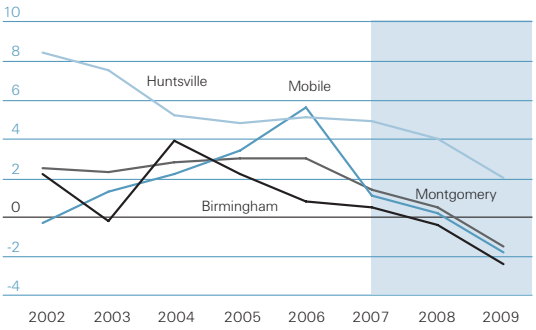
Source: BBVA ERD

Metro Statistical Areas' Productivity
Index. 2001 US MSAs Productivity=100



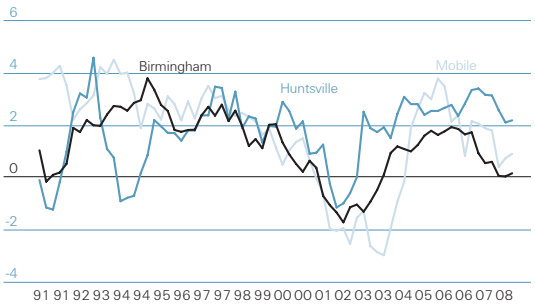
Source: BBVA ERD

Alabama Metro Areas GDP
(YoY variation %)



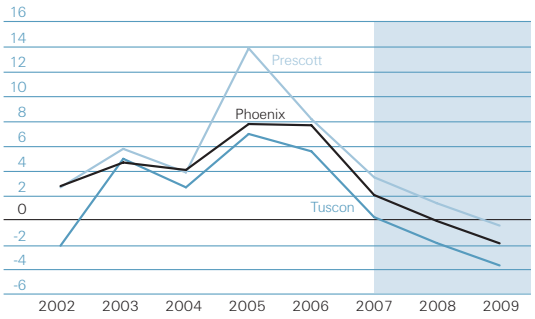
Source: BEA and ERD

Alabama Metro Employment
Quarterly YoY variation (%)



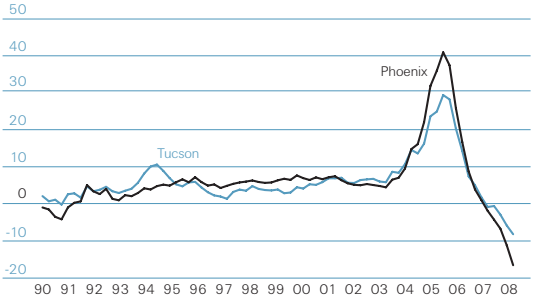
Source: BLS

Arizona Metro Areas GDP
(YoY variation %)



Source: BEA and ERD

Phoenix and Tucson Housing Prices
(Quarterly YoY Variation %)



Source: OFHEO

Alabama urban system is distributed trough the whole state

In 2007, 3.25 million people lived in Alabama's 11 MSAs, accounting for 70.2% of the state's total population. Alabama's MSAs have grown in relative importance, and now account for 79.6% of the state's employment and 81% of its total GDP in 2006.

The state's major metro area has a population of 1.1 million; its three medium-sized cities have a population of approximately 400,000 each, while seven smaller cities are home to less than 250,000 people.

In 2007 and 2008, economic activity is as reflected by decreasing employment trends. Our estimates indicate an average growth rate in the state's MSAs GDP of 2% in 2007 and 1% in 2008. This downward trend began in 2004 and will continue through 2009, when the state's GDP will contract -1.1%.

Employment growth in Alabama's MSAs has decreased through 2008. While it is increasing in Mobile and Huntsville, employment remains unchanged in Birmingham, and is decreasing in Decatur and Dothan. In this environment, personal income growth grew more in Alabama's metro areas than the national average. Higher household income growth has helped to sustain local housing prices, in the face of lower demand.

Arizona has one big city surrounded by several metropolitan areas. Housing depreciation is the main threat to the MSA's economy.

Arizona's six MSAs had a population of 5.87 million people in 2007, 92.5% of the state's total population. Those six MSAs generated 96.6% of the state's total GDP and accounted for 92.5% of employment. Phoenix accounted for 71% of the state's urban population and 75% of employment. Tucson represents 16.5% of the state's population and 15% of employment.

The slowdown in residential real estate has hit both of Arizona's major metropolitan areas hard. Housing starts and prices have dropped significantly. Building contraction has negatively impacted employment and overall economic activity. In 2007, metro GDP in Phoenix and Tucson declined approximately 6% to an average of 2%. For 2008 and 2009, we forecast further economic slowdown.

Housing prices in Phoenix have taken a major blow: prices in 3Q08 were almost 20% below peaks reached at the end of 2006. An oversupply of housing will limit residential investment in 2009.

In October 2008, employment in Arizona's MSAs was contracting at -2.6% yoy rate. Although job losses were pronounced, especially in Yuma and Tucson, similar trends hit Phoenix. Overall, per capita income in Arizona's MSAs in the current decade has grown at rates similar to the national average.

Colorado's urban economy is concentrated in two metropolitan areas, which produce 75% of the state's GDP

There are 7 MSAs in Colorado with one city center that accounts for 60% of the state's urban population and one secondary city where 14.6% of the state's urban population resides. In 2007, the urban population represented 86.2% of the state's total population. Almost 75% of the state's economic GDP is generated in its two major metropolitan areas. From 2001 to 2006, real GDP growth rates averaged 2.1% in Colorado Springs and 2.3% in Denver.

From 2006, data indicates a gradual economic slowdown that is reflected in lower GDP growth of around 2.0% in 2007 and 1.6% in 2008 in the major metro areas. In 2009, our forecast suggests that neither Denver nor Colorado Springs will experience positive economic growth.

In 2008, metro employment is still growing, but at a lower pace. In October, urban employment grew 1.0%, half the rate observed a year earlier. Employment is growing in all Colorado's metro areas, with special intensity in Grand Junction (4.5%) and Greeley. As a consequence of this, personal income per capita in Colorado's MSAs is increasing at higher rates than the national average, which could eventually help to normalize the housing market.

Although housing prices remain relatively stable in most of the state's MSAs, the risk is for further housing price declines that could jeopardize economic growth, especially in the major urban metropolitan areas.

Florida is a metropolitan state: almost 95% of the state's population lives in an urban environment.

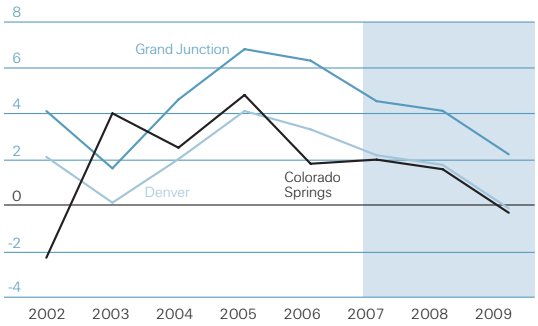
State population, economic activity and, therefore, employment are highly concentrated in Florida's 20 metro areas. 94.1% of the population, 99.5% of the economic activity and almost all the state's employment are located within the state's existing MSAs. Almost 60% of the state's urban population is concentrated in three cities: Miami (32%), Tampa (16%) and Orlando (12%). In 2007, 17.2 million people lived in Florida's urban areas.

Since 2006, a residential meltdown has impacted Florida's metro areas dramatically, forcing a decline in housing starts and causing housing prices to decline significantly. In 2007, the residential investment slowdown and lower household consumption—as a result of real estate wealth destruction—led Florida's major cities into economic recession. For 2008 and 2009, our forecast indicates further economic deterioration in most of the state's MSAs. Miami and Tampa GDP will see negative growth rates until 2010.

New Mexico urban areas represent 75% of the state economic output

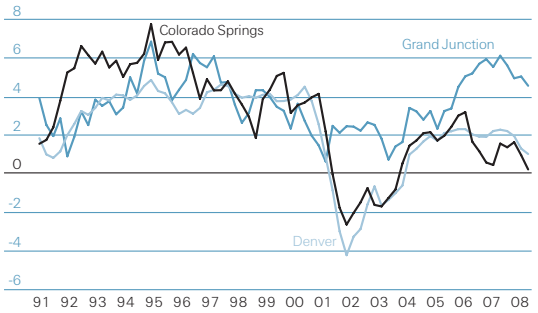
New Mexico's metro areas include 2 out of 3 of the state's habitants. In 2007, the urban population was 1.3 million, 66% of the state's total. Metropolitan population is mainly concentrated in Albuquerque (42% of total) and Las Cruces (10%). However, the MSA's urban economic relevance is higher. In 2006, the state's four MSAs produced 73.4% of the state's total employment and 74.6% of the state economic production.

Colorado Metro Areas GDP
(YoY variation %)



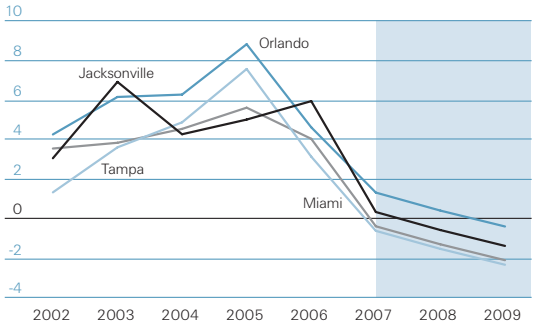
Source: BEA and ERD

Colorado Metro Employment
Quarterly YoY variation (%)



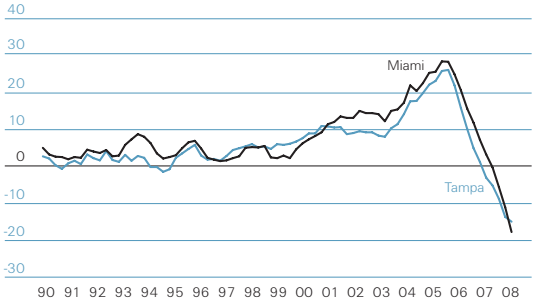
Source: BLS

Florida Metro Areas GDP
(YoY variation %)



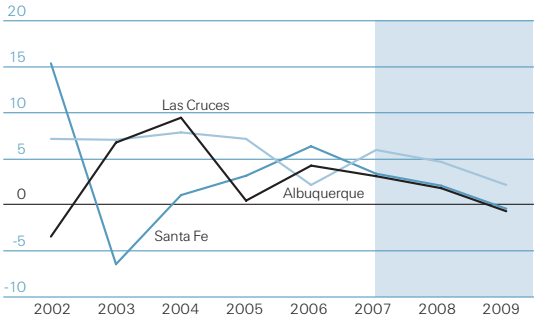
Source: BEA and ERD

Miami and Tampa Housing Prices
(Quarterly YoY Variation %)



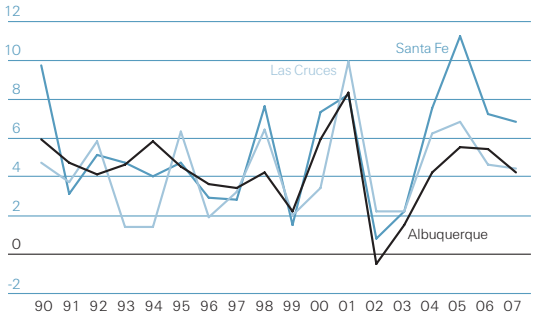
Source: OFHEO

New Mexico Areas GDP
(YoY variation %)



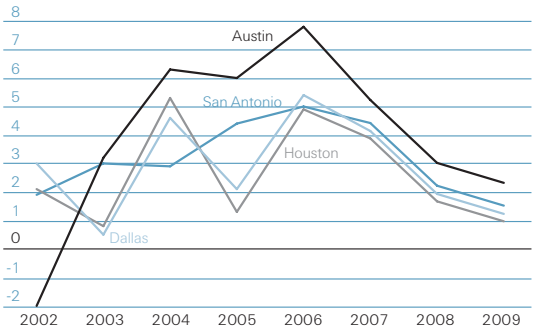
Source: BEA and ERD

Personal Income Per Capital
YoY variation (%)



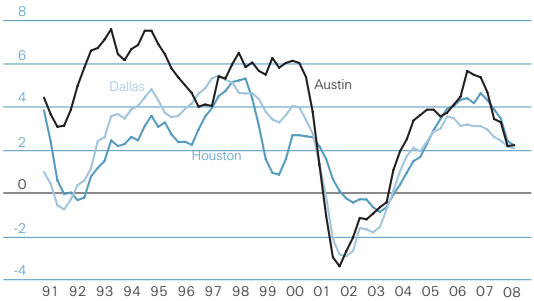
Source: BLS

Texas Metro Areas GDP
(YoY variation %)



Source: BEA and ERD

Texas Metro Employment
Quarterly YoY Variation (%)



Source: OFHEO

In 2007 and 2008, New Mexico metro employment showed a decreasing trend, especially in Albuquerque and Santa Fe, which mirrors an economic slowdown. According to our estimates, metro GDP growth rates weakened in 2007, a trend that will continue in 2008 and 2009.

In the last four years, personal income growth rates in New Mexico's metro areas have been above the national average.

Texas has an urban system with two main metro areas

In 2007, the 24 MSAs in Texas had a total population of almost 21 million, which represented 87.2% of state's population. Those MSAs totaled 94.8% of the state's total employment, which produced 95.4% of total GDP.

Urban employment and economic activity grew in 2007 and 2008 above other metro areas. Our estimates indicate that in 2007 Houston, San Antonio and Austin grew at rates close to 4% while it was slightly above 5% in Dallas. However, in 2008, the economic slowdown affected almost all of Texas' metro areas, and GDP growth rates fell to around 2% in all MSAs. In 2009, we expect GDP growth to remain positive, although lower than in previous years.

Although building activity has decreased dramatically, housing prices have remained relatively stable in most of the state's metro areas showing that house prices did not increase significantly over its fundamental determinants. In fact, in 3Q08 all the state's MSA showed house price increases. However, the current economic recession could have a negative impact on some of Texas' metro housing markets and housing prices could begin to decline, as demand slows down.

Commercial Real Estate

Risks increase as economy slows down

As GDP moderates, commercial real estate investment will drop sharply in the next quarters

From 1990 to 2008, non-residential real estate investment grew at an average annual rate of 1.4%, but its growth rate was especially intense from 2Q06 to 3Q08, when it averaged 12.1%. In 4Q08, Commercial Real Estate (CRE) investment is expected to increase 13.1% yoy. However, in 2009 it will drop sharply; our forecast points to a retraction of -5.7%. In 2010, the negative trend will continue and real estate investment will decrease further to -17.2%. The main factors behind the lower economic activity are negative returns on commercial investment and tightening credit conditions.

In general, a weakening of CRE trails the overall economy by some quarters. CRE is driven mainly by two economic factors: employment and personal consumption. Employment is a proxy of expanding businesses which affect office floor space demand, while personal consumption affects retail sales growth.

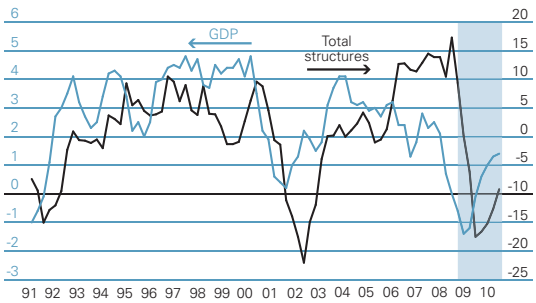
The labor market will continue to deteriorate as almost 2 to 4 million non-farm jobs could be eliminated in 2008-2009. Approximately 30% of those will come from the service sector, leaving approximately 278 million square feet (sq. ft.) of commercial floor space vacant (out of 13.5 billion sq. ft. of office and shopping centers space available). Another 40% of the jobs will be lost in the manufacturing sector, leaving almost 450 million sq. ft. of industrial space unoccupied (out of 13 billion sq. ft. supply). In addition, the steep moderation in personal consumption, which has led to a 4.5% yoy drop in real retail sales in 3Q08, will weigh against the current use of commercial space.

With fewer jobs and retail sales decreasing, CRE vacancy rates are increasing and rents are moderating. As a consequence of the economic slowdown, CRE vacancies have grown from 12.6% of total commercial space available in metropolitan areas in 2007 to 14.1% in 3Q08: vacancies exceeded 10.9% in downtown markets and 15.8% in the suburban markets.

For the first time since 1994, commercial real estate returns will be negative in 2009, ending a 15-year cycle of positive returns

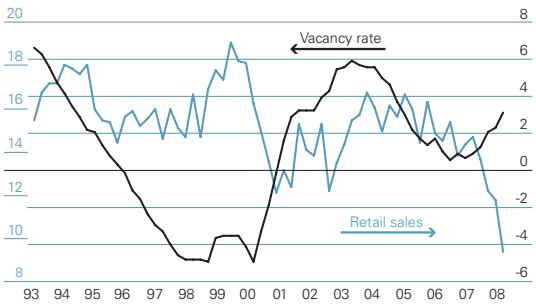
CRE has produced higher returns than other financial instruments in the past, but higher vacancy rates and lower prices will produce negative returns in 2009. In 2008, commercial returns will be slightly above long-term notes, averaging 7.0%. However, quarterly data already shows a sharp downward trend that will mark the end of a 15-year cycle of positive returns. Although rent from current tenants will rise in 2009, it will not mitigate the negative effects of increasing vacancy rates and price declines. Income returns will remain between 5% and 7% per year, but capital returns will slip into negative figures as CRE prices decrease.

GDP and Non-Residential Structures Investment
YoY (%)



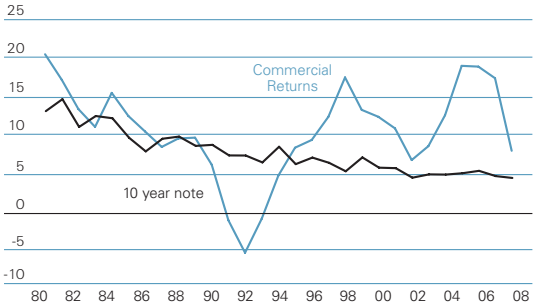
Source: BEA and BBVA ERD

Commercial Vacancy Rate and Retail Sales
(%) and YoY Change (%) in real terms



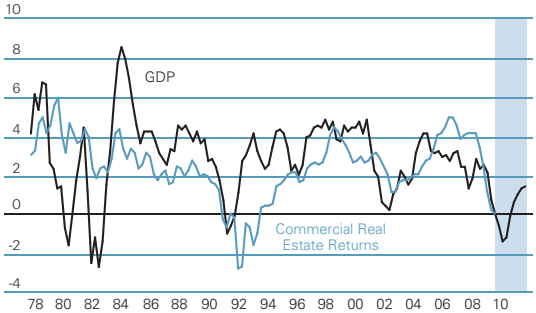
Source: CBRE and Census

Commercial Real Estate Returns vs. Treasury
Total returns (%) and 10 year note yield (%)



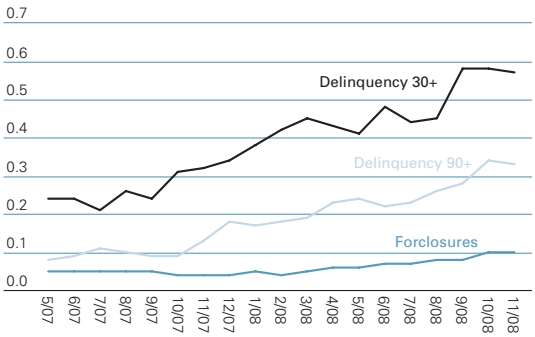
Source: NCREIF and FR

GDP and Commercial Real Estate Returns
4Q variation (%) and Quarterly returns 2QMA (%)



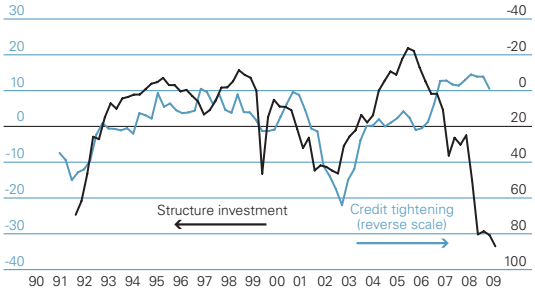
Source: BEA, NCREIF and BBVA ERD

Commercial Property Delinquency (30+ and 90+ days) and Foreclosure rates (%)



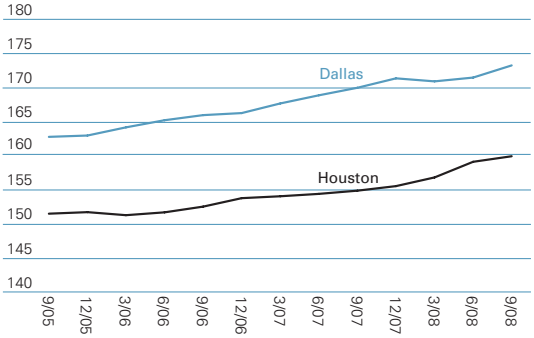
Source: Bloomberg

Structures Investment & Credit Conditions YoY Change (%) and Credit Standards (tightening) (4Q delay)



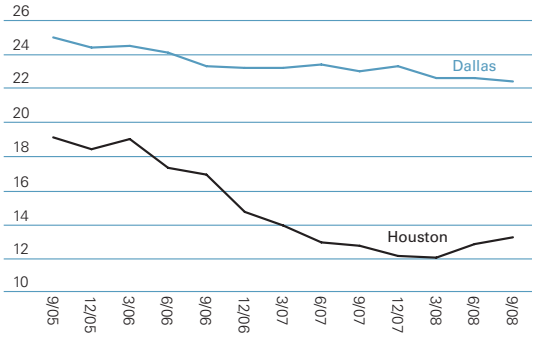
Source: BEA, FRB and BBVA ERD

Dallas and Houston Commercial Real Estate Commercial Inventory (million of square feet)



Source: Cushman Wakefield

Dallas and Houston Commercial Real Estate Vacancy Reates (%)



Source: Cushman Wakefield

Expected further economic slowdown also suggests that CRE returns will be negative through 2009 and will not recover until 2010. In general, the gap between the planning and building of commercial property stresses the risk of CRE financing.

Increasing delinquency and foreclosure rates partly justifies tighter credit conditions for commercial real estate

Delinquencies and foreclosures of CRE have been growing since mid 2007. Despite current low interest rates, delinquencies and foreclosures in the last eighteen months have increased dramatically: 90+ days delinquency rates are now 0.35% of total portfolios, 3.5 times the rate observed at the beginning of 2007. Foreclosures have doubled to 0.1% of total loans. This has led to tighter credit conditions for CRE financing. While delinquencies on CRE loans have crept up, they remain low and haven't inflicted the damage we've seen in the residential market.

Historically, credit-tightening policies have limited CRE investment, with some lag, as was the case in early the 90s and early 2000s. Today, large and small commercial developments nationwide are at risk of being delayed or stopped, as lenders tighten credit standards on construction loans. In fact, there is evidence that construction lenders are demanding so-called "recourse" construction loans, which allow a lender to go after a delinquent developer for some kind of repayment even after taking back the property.

Combined with a slowing economy, the lack of credit will curtail activity in the CRE sectors. There will be a slowdown in the net absorption of space, which would lead to higher vacancies and more modest rent growth.

While some metro commercial real estate markets within the BBVA Compass footprint will remain relatively stable…

In the last three years, Texas' major metro areas have seen demand of CRE exceed supply, leading to lower vacancy rates. Strong job creation and high personal consumption growth rates backed demand for new office and retail space. Since 2003, total employment growth has averaged 3.0% a year in Houston, 2.5% in Dallas, 3.5% in Austin and 2.6% in San Antonio metro area, leading to a strong demand for office and industrial space in all four metro areas. From 2005 to 2008, the supply of new CRE increased 18% a year in Houston and 2.1% in the Dallas MSA, while vacancy rates dropped to 22% and 13.5% rates respectively.

In 2008, weaker CRE demand is causing vacancy rates to grow slightly in the larger metropolitan markets. In 3Q08, 21 million of Houston's total of 160 million CRE square feet was vacant. In Dallas, the numbers were similar, with 38 million of a total 173 square feet vacant.

Although demand for new CRE will remain weak in 2009, the lower supply of new floor space in Texas' major metro areas will keep vacancy rates relatively stable, albeit rising. Nevertheless, rental rate growth will be limited by increasing supply relative to demand, not only in suburban markets but also in major central business districts. Overall total returns will remain positive in Texas, as CRE prices will show no significant declines and rents will increase.

Despite the recent slowdown, employment in the Denver metro area grew at a rate of 16% during the last five years, with a strong increase in high value-added services. Demand for office space has been intense since 2004, leading to a strong reduction in vacancy rates and new CRE construction. Vacancy rates in the Denver metro area were 13.4% in 3Q08 while total inventory increased by 3.1% annually since 2005 to reach 95.4 million of square feet.

Nonetheless, lower demand for office space in 2008 is negatively affecting CRE and will continue to do so in 2009. Consequently, vacancy rates are increasing slightly. This trend will continue through 2009, as employment weakens. Rental rents, which grew at an average of 17% in the last three years will slow as vacancies increase. However, returns will remain positive, as prices and income from rent remain stable.

...other metro markets are already showing weaknesses.

Since the beginning of 2007, the economic slowdown has been negatively affecting CRE in all of Florida's metro areas. According to the Bureau of Economic Analysis (BEA), Florida experienced an economic retraction in real terms. Employment has declined throughout 2008.

Weak demand has led to a rapid increase in supply and vacancy rates in most of Florida's metro areas. Vacancy rates in Tampa and Miami increased more than 2% in the last four quarters to reach 14.9% and 12.9% respectively. Despite the fact that rental rates have remained relatively stable for currents tenants, CRE prices depreciated in most local markets. In 2009, the recession will stress CRE even further throughout Florida.

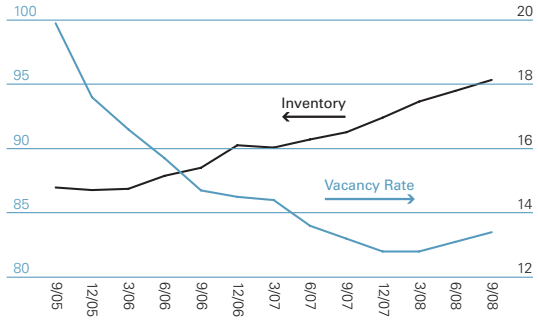
Increasing vacancy rates and falling prices will cause negative returns in 2008 and in 2009. Based on our forecast, Florida's CRE markets will begin to recover in 2010, in concordance with a stronger labor market and increased consumer confidence.

In Phoenix, new supply increased dramatically in the last three years, averaging 6% per year. Since the beginning of 2007, however, demand for commercial space has weakened sharply as new supply has not been absorbed. As a result, vacancy rates have increased significantly, from 12% to 19% in 3Q08, and rents have decreased slightly. Returns on CRE are already negative and will not improve in 2009.

It will take several quarters for commercial real estate to recover after the local economies improve

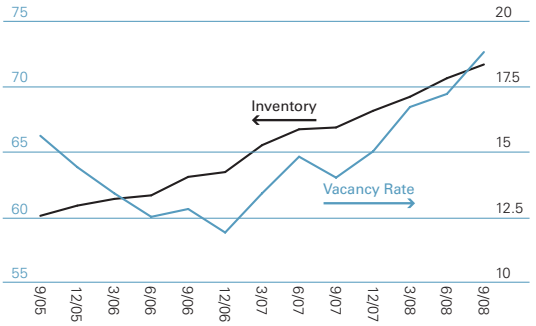
Historically, CRE investment has lagged the general economic recovery. Our forecast predicts that local economies in the BBVA Compass footprint will recover through 2009 and will have positive growth rates in 2010. Positive gains in employment and household consumption will mark the beginning of the CRE upturn. Commercial price appreciation will be difficult to find in the major metropolitan markets before 2011, due to excess supply.

Denver Commercial Real Estate
Inventory (million of square feet) and Vancancy rates (%)



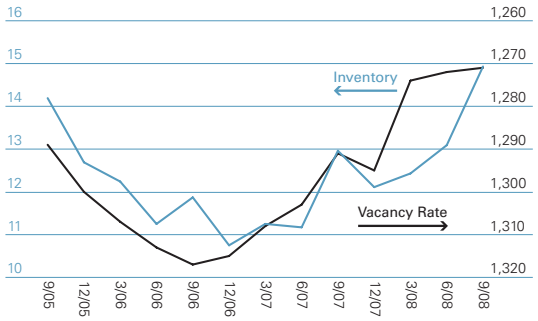
Source: Cushman Wakefield

Phoenix Commercial Real Estate
Inventory (million of square feet) and Vancancy rates (%)



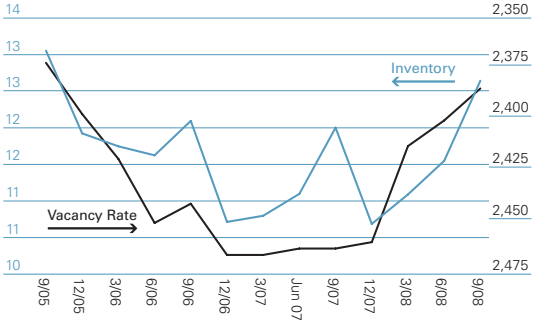
Source: Cushman Wakefield

Tampa: Commercial Real Estate and Employment Vacancy Rates(%) and Total ('000)



Source: Cushman Wakefield

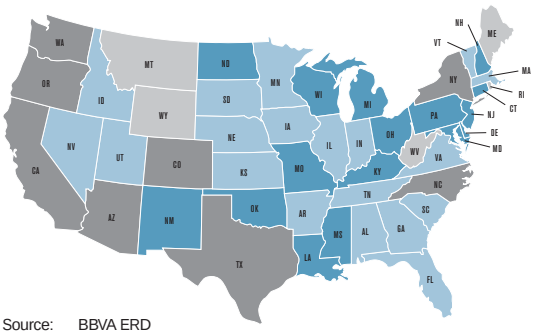
Miami: Commercial Real Estate and Employment Vacancy Rates(%) and Total ('000)



Source: Cushman Wakefield

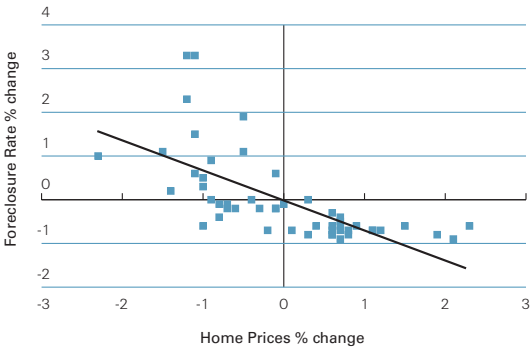
Footprint

Top Performers
Positive Outlook
Limited Upside
Greatest Uncertainty



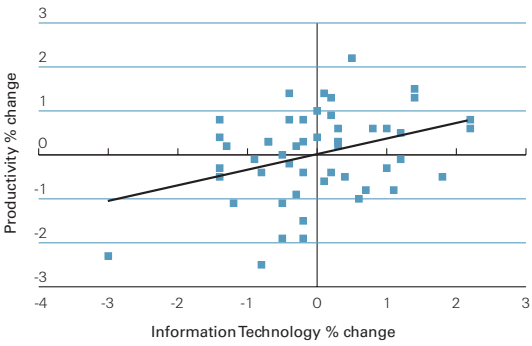
Source: BBVA ERD

BBVA State Ranking Components



Source: Mortage Bankers Association & OFHEO

BBVA State Ranking Components



Source: BLS

While the economic recovery is likely to be slow as deleveraging takes place, differences at the regional level could be significant. Economic growth rates in the next upward cycle could vary greatly among states, generating both challenges and opportunities. In order to determine these trends, we have created an analytical framework separating short- and long-term determinants that can better explain the expected recovery paths. Out study included eight variables. We ranked the 50 states to obtain individual indexes, which we normalized; and then, we added the totals to obtain an overall ranking.

In the short-term, the states positioned for a faster recovery are those which are experiencing a milder adjustment in the housing sector, and in which the output gap (the difference between actual and potential growth) is smaller. These states also are where home appreciation is closer to its long-term average and experienced the lowest delinquency and foreclosure rates.

These variables allow us to capture the different dynamics between income, wealth, credit and consumption. In general, we would expect that states with a lower decline in home prices and smaller increases in delinquencies and foreclosures are positively correlated with stronger labor and credit markets, and where household wealth pressures are less. These states are also more likely to experience lower pressures on consumption, investment and economic growth. We also assume that states with a smaller output gap are more likely to experience a milder downward adjustment. While it's possible that states with a smaller output gap also have lower potential growth rates, it is likely that excess capacity is smaller and the pace of recovery is under less pressure.

In the long-run, we expect that economic growth will be better supported by stronger fundamentals. These fundamentals are captured through the degree of trade openness (measured as the share of exports to gross domestic product), solid demographics (measured with the expected population growth rate), higher growth rates in labor productivity, and the economic structure. We assign a better ranking to states with a relatively higher export base, and where the economic structure is biased towards industries that are more likely to benefit the most from our estimates of global trends. These industries are mainly information technology, mining and professional services. We expect these industries to generate a higher level of both value added and high-skill employment growth. These sectors are also more likely to benefit from our expected global trends, which favor commodities production, demand for goods and services by an aging population and a greater share of emerging markets in the global economy.

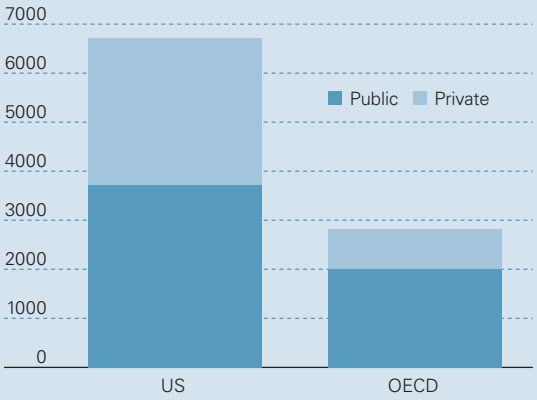
According to our results, Texas, California, Washington and North Carolina are among the highest ranked states, as they benefit from low short-term pressures and solid long-term prospects. In these states, the absence of a housing bubble and strong job creation help to contain downward short-term pressures, while solid demographics, a diversified economic base and a strong export sector provide support for long-term growth. Though Florida and Arizona both suffer short-term pressures, their overall ranking is higher than other states with fewer short-term issues but weaker long-term prospects.

Health Care Challenges in the US: Regional Focus

US health system, an outlier

The US spends more on health care than any other nation in the world. According to OECD Health Data 2008, US spending was 15.3% of GDP in 2007, more than half of it being private. France and Germany devoted around 11% of GDP, and the OECD average was 8.8% (less than one-quarter privately funded). The gap is even higher in per capita terms, with spending in the US being 6,700 US$ PPP, more than twice the OECD average of 2,800 US$ in 2006.

Total Health Expenditures in US and OECD
(US$ ppp, 2006)



Source: OECD

Health care is provided by a diverse set of entities. 60% of the population has primary employer-based private health insurance. Nearly 30% are covered by government programs, and around 10% purchase insurance individually. Finally, about 15% have no insurance (the figures add to more than 100 percent because some people are covered by more than one type of program). The publicly-funded health care programs (mainly Medicare, Medicaid and the State Children's Health Insurance Program, TRICARE, the Veterans Administration) provide health services for nearly all elderly, poor, disabled and children, military and veterans. Federal law mandates public access to emergency services regardless of the ability to pay, through the Emergency Medical Treatment and Labor Act.

One-third of total personal health expenditures is paid by private insurance, one-third by federal government, 15% by private out-of-pocket, and 11% by state and local governments. The major part corresponds to hospital care, physician care and prescription drugs.

Policy priorities: access, efficiency, quality, and sustainability

The U.S. is the only high-income economy that does not have universal health care. US Census statistics report that 15.3% of people did not have health insurance in 2007, i.e. 45.7 million. Besides, underinsured population adds another 24 million. Some analysts claim that these figures should be qualified, since one-quarter of the uninsured are eligible for Medicaid, ten million earn annually more than $50,000 (enough to afford coverage in most states) and many of them are young and healthy. Anyway, this issue merits action, since uninsured end up getting less care, and worse health (and financial) outcomes[1].

Concerning the impact of spending on health status (the value for money equation), despite the higher expenditure, on most measures of health service use, the US is below the OECD median[2]: In addition, life expectancy, infant mortality, and obesity rates have improved at a slower pace in the US than in other industrialized economies.

The Congressional Budget Office (CBO)[3] projects, even within a 'no-policy-change scenario', the US spending on health care doubling by 2035, reaching 31% of GDP. Net public federal spending on Medicare and Medicaid would amount to 9% of GDP in 2035. This projection is driven by the so-called "excess cost growth", that is, the difference between the increase of the cost per beneficiary and the growth of per capita income (after adjusting for changes in age distribution of the population). The adoption of new medical technologies, the rising relative price of medical goods and services, the growth in personal income, and the decline in out-of-pocket payments by consumers lie behind this factor[4]. These developments would have a huge impact in the US economy. First, the challenge to public finances would be enormous, and much more important than the one stemming from pension expenditure (according to the CBO, public pension spending would increase to 6% of GDP in 2035). Second, the private health insurance market would boom, getting a share of GDP similar to that of the financial and insurance sector nowadays (20% of GDP). Third, a policy response for the 'core' of uninsured (around 25 million) seems inevitable.

1 See Doyle, J.J. (2005): "Health Insurance, Treatment and Outcomes: Using Auto Accidents as Health Shocks", The Review of Economics and Statistics, vol.87, issue 2, pp.267-270, and the references therein.

2 See Anderson, G.F., U.E. Reinhardt, P.S. Hussey, and V. Petrosyan (2003): "It's The Prices, Stupid: Why The United States Is So Different From Other Countries", Health Affairs, vol.22, issue 3, pp.89-105.

3 CBO (2007): The Long-Term Outlook for Health Care Spending, November.

4 See Anderson et al. (2003), op.cit. for the price hypothesis, Hall, R.E. and C.I. Jones (2007): "The Value of Life and the Rise in Health Spending", The Quarterly Journal of Economics, vol.122, issue 1, pp.39-72 for the income explanation, CBO (2007) op.cit. for the technological approach, and Follette, G. and L. Sheiner (2005): "The Sustainability of Health Spending Growth", Finance and Economics Discussion Series 2005-60, The Federal Reserve Board for the out-of-pocket option.

Health Care Challenges in the US: Regional Focus

Large and increasing regional differences, not explained by demand-side factors

The US differs with most of other high-income countries in having a relatively decentralized health system. CBO[5] argues that the related geographic variation in health care inputs and output is not explained by prices paid for medical services, health status of the populations, income or preferences, but by the way medicine is practiced: lack of agreed protocols with the best treatments, financial pressures and incentives faced by medical providers, and the supply of physicians and other resources in the state.

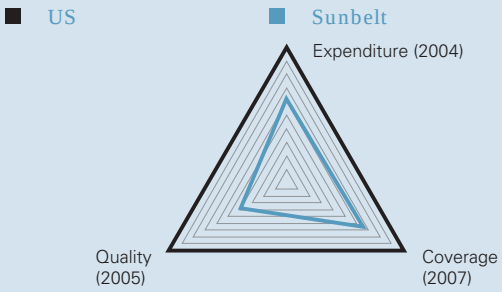
The variation in total health care spending per capita has trended upward in recent years, and is much higher than in Canada, and somewhat higher than in the United Kingdom (economies with more centralized financing). Data from the Centers of Medicaid and Medicaid Services (CMS) show that this is mainly due to private (and to a lesser extent to Medicaid) divergences, since geographic variation in Medicare spending has dropped sharply over the past decades.

Besides, a higher expenditure does not appear to improve significantly the quality indicators. The Agency for Healthcare Research and Quality (AHRQ) indicators (which distinguishes types of service and settings show that the three leaders (Minnesota, Wisconsin, and North Dakota) reach a 47% quality differential (66.3 vs. 45.2 in the US average), spending just nine percent more than the average. A parallel finding holds for the laggards (Arkansas, Georgia, and Louisiana), where the negative quality gap (25.3 vs. 45.2) is much higher than the expenditure gap (ten percent lower).

Higher challenges in the Sunbelt states, albeit from different starting points

No state does well or poorly in all areas. Texas, for example, ranks in the lowest 25th percentile (among the worst, 10th on vaccinating older people against pneumonia), but exhibits some of the best nursing home indicators. However the BBVA Compass footprint Sunbelt states as a whole (Alabama, Arizona, Colorado, Florida, New Mexico, and Texas) face a bigger challenge. Since the early nineties, insurance coverage has been significantly lower than the national mean. In 2007, the BBVA Compass footprint Sunbelt averaged 79%, six points lower than the US. This gap is similar to that of per capita expenditure, 4,900 US$ vs. 5,300 US$ which confirms the causation between coverage and care. Concerning quality, AHRQ reports a significantly higher disadvantage (39.7 vs. 45.2), with a negative trend in all States, except Arizona and Colorado.

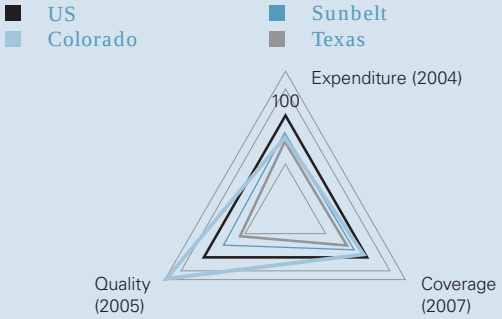
Health System Indicators US vs. Sunbelt
(US = 100)



Source: BBVA ERD, based on data from CMS, US Census and AHRQ

Nevertheless, Sunbelt States also show significant divergences. Colorado health system coverage is similar to that of the US, and its quality is even above the national average, at lower per capita expenditure (4,700 US$ vs. 5,300 US$ in 2004). By contrast, Texas (and only slightly better New Mexico), spends a similar amount of funds than Colorado (around 4,600 US$ per capita), but underperforms in both output measures (quality is just 35.1, and coverage hardly reaches 75%).

Health System Indicators in the Sunbelt
(US = 100)



Source: BBVA ERD, based on data from CMS, US Census and AHRQ

Regional lessons for the upcoming health reform agenda

Summing up, the regional evidence highlights large differences in spending for the care of similar patients that do not improve proportionally their health condition. If correctly identified, it suggests potential efficiency gains, that is, health improvements at almost zero cost. Therefore, policy challenges should be tackled including a regional approach, in order to try to generalize the States best regulatory practices.

5 CBO (2008): Geographic Variation in Health Care Spending, February.

States in Figures

	US	Alabama	Arizona	Colorado	Florida	New Mexico	Texas
Patents (2007)							
Total	93,665	358	1,826	1,983	3,092	304	6,228
Inventions	79,527	300	1,571	1,745	2,358	286	5,733
Designs	13,494	55	249	232	642	15	467
Botanical plants	364	2	-	1	83	-	8
Reissues	280	1	6	5	9	3	20
% share							
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Inventions	84.9	83.8	86.0	88.0	76.3	94.1	92.1
Designs	14.4	15.4	13.6	11.7	20.8	4.9	7.5
Botanical plants	0.4	0.6	0.0	0.1	2.7	0.0	0.1
Reissues	0.3	0.3	0.3	0.3	0.3	1.0	0.3
Business (2007)							
Births	923,932	9,813	18,208	23,035	75,533	6,158	55,865
Deaths	926,283	10,710	16,019	23,080	60,724	6,003	55,269
Births/deaths ratio	1.00	0.92	1.14	1.00	1.24	1.03	1.01
Bancruptcies	23,889	285	332	536	1,455	102	2,241
Firms (2005)							
Total (1,000)	5,984	80	106	128	422	37	386
Less than 20 employees (1,000)	5,358	68	91	113	384	32	337
% of total	90	85	86	88	91	85	87
Less than 500 employees (1,000)	5,966	78	103	125	418	36	381
% of total	100	97	97	98	99	96	99
Employment (2005)							
Total (millions)	116.3	1.7	2.2	1.9	7.1	0.6	8.3
Less than 20 employees (millions)	21.3	0.3	0.4	0.4	1.3	0.1	1.4
% of total	18	18	16	21	18	22	17
Less than 500 employees (millions)	58.6	0.8	1.0	1.0	3.2	0.3	3.9
% of total	50	49	49	52	45	57	47
Payroll (2005)							
Total (billion dollars)	4,483	53	76	76	239	18	316
Less than 20 employees (billion dollars)	696	8	12	13	43	4	46
% of total	16	15	15	18	18	19	15
Less than 500 employees (billion dollars)	2,013	24	34	35	105	9	131
% of total	45	45	44	46	44	52	41
Number of Bridges (2007)	599,766	15,881	7,348	8,366	11,663	3,850	50,271
Deficient & obsolete	152,316	4,057	781	1,404	1,994	698	10,037
%	25.4	25.5	10.6	16.8	17.1	18.1	20.0
Structurally deficient	72,524	1,899	181	580	302	404	2,186
%	12.1	12.0	2.5	6.9	2.6	10.5	4.3
Functionally obsolete	79,792	2,158	600	824	1,692	294	7,851
%	13.3	13.6	8.2	9.8	14.5	7.6	15.6
Disbursements for Highways							
Highway Trust Fund (US$million, 2007)	33,694	768	436	486	2,123	316	1,887
Per capita (1,000 US$)	111.7	165.9	68.8	100.0	116.3	160.6	78.9
Federal Transit Administration (US$million, 2007)	9,286	64	209	185	341	31	450
Per capita (1,000 US$)	30.8	13.7	33.0	38.1	18.7	15.6	18.8
State (2006, US$ million)	117,048	1,684	2,662	1,490	7,725	942	9,101
% growth rate 2006-2000	30.3	35.1	30.5	7.0	83.6	-19.0	60.7

Source: U.S. Patent and Trademark Office, U.S. Employment and Training Administration, U.S. Census Bureau, U.S. Small Business Administration & U.S. Federal Highway Administration

Forecasts

Year-over-year % change

	3Q09	2007	2008	2009
US				
Real GDP	-2.9	-1.6	-0.5	0.5	2.0	1.4	-0.8
Employment	-1.3	-2.1	-2.7	-2.9	1.1	-0.2	-2.6
Personal Income	2.7	2.6	2.4	2.5	6.2	3.9	2.5
Home Sales	-9.3	-13.6	-17.4	-10.2	-14.8	-17.3	-12.4
House Price	-6.5%	-7.0%	-6.0%	-3.0%	1.6	-4.9	-4.3
Alabama							
Real GDP					1.8	0.9	-1.1
Employment	-0.1	-0.1	0.2	0.3	1.3	0.4	0.2
Personal Income	4.0	3.7	3.2	3.3	5.7	4.8	3.5
Home Sales	-17.2	-6.2	1.0	5.4	-6.9	-23.0	-6.5
House Price	1.5	0.6	.04	-3.3	5.8	3.0	-1.2
Colorado							
Real GDP					2.0	1.6	-0.3
Employment	1.1	1.0	1.1	1.3	2.2	1.4	1.2
Personal Income	4.6	5.2	5.0	4.7	5.9	5.2	4.9
Home Sales	-1.7	-5.7	0.5	2.0	-3.1	-7.0	-0.7
House Price	-0.5	-0.8	-1.2	-1.2	2.5	0.7	-1.5
New Mexico							
Real GDP					2.8	1.5	-1.0
Employment	0.6	0.9	0.7	1.0	1.3	0.7	1.0
Personal Income	4.5	4.2	4.0	3.8	4.3	5.7	3.9
Home Sales	-25.4	-27.8	-27.4	-30.3	-23.0	-26.8	-28.4
House Price	-0.8	-0.4	0.2	0.5	7.8	1.0	0.2

	4Q08	1Q09	2Q09	3Q09	2007	2008	2009
Sunbelt							
Real GDP					2.3	0.8	-0.3
Employment	0.5	0.1	-0.1	-0.1	1.8	0.6	-0.0
Personal Income	3.5	3.4	3.2	3.2	6.2	4.6	3.3
Home Sales	-3.2	-1.3	-2.3	-3.1	-13.4	-11.6	-1.7
House Price	-7.2	-7.3	-6.9	-6.7	1.8	-5.5	-6.8
Arizona							
Real GDP					1.8	-0.3	-2.1
Employment	-2.3	-3.0	-2.4	-1.7	1.2	-1.2	-2.1
Personal Income	2.0	1.9	1.6	1.8	5.5	2.9	1.8
Home Sales	40.5	24.9	3.6	-14.5	-26.4	7.7	1.1
House Price	-11.2	-10.4	-8.3	-7.0	0.6	-9.0	-7.9
Florida							
Real GDP					0.0	-0.9	-1.7
Employment	-1.8	-2.0	-1.7	-1.4	0.5	-1.2	-1.5
Personal Income	2.0	1.6	1.2	1.2	5.2	2.8	1.3
Home Sales	-9.5	-7.6	-16.8	-24.0	-27.9	-13.9	-15.8
House Price	-16.2	-17.4	-18.4	-19.1	-0.8	-12.8	-18.6
Texas							
Real GDP					4.1	1.9	1.2
Employment	2.0	1.7	1.3	1.1	2.9	2.3	1.3
Personal Income	5.5	5.2	4.9	4.8	7.5	6.4	4.8
Home Sales	-3.3	0.9	4.8	10.7	-2.6	-11.5	5.6
House Price	1.9	1.7	1.2	0.8	6.3	3.4	1.1

Source: BBVA Compass, BEA, BLS, NAR, Census and OFHEO

Economic Estructure

	US	Sunbelt	AL	AZ	CO	FL	NM	TX
GDP (2007. $ Billions)	13,808	2,602	166	247	236	735	76	1,142
Population (2007. Thousands)	301,621	48,041	4,628	6,339	4,862	18,251	1,970	23,904
Labor Force (3Q08. Thousands)	154,732	30,138	2,170	3,134	2,749	9,338	958	11,788
NonFarm Payroll (3Q08. Thousands)	137,318	26,380	2,011	2,612	2,369	7,899	848	10,643
Income Per Capital (2007, $)	38,564	36,824	32,404	32,900	41,019	38,444	30,604	37,006
Households (2007. Thousands)	115,564	22,122	1,854	2,226	1,886	7,182	746	8,307
Houses/1000 Hab. (2007)	424.0	413.4	461.8	420.8	437.6	477.7	437.6	394.6
House Price (2006. $ Thousands)	246.0	200.2	165.0	260.0	240.0	248.0	190.7	141.0
Home Ownership Rate. (2006. %)	68.8	69.9	74.2	71.6	70.1	72.4	72.0	66.0
Exports of Goods (2007. $ Billions)	1,162.7	256.5	14.4	19.2	7.3	44.8	2.6	168.2

Source: BEA, BLS, NAR, Census and FHFB

BBVA Compass

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