BBVA Research

U.S.

Weekly Watch

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Economic Analysis

Hakan Danış
hakan.danis@bbvacompass.com

Highlights

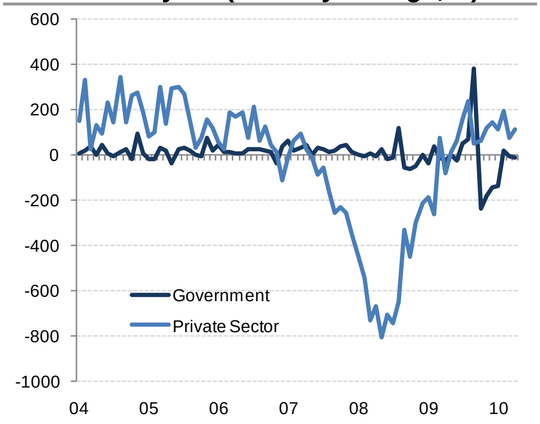
The Fed sees no reason at present to change policy stance

Minutes of the last FOMC meeting held on December 14, 2010 include no surprises. Federal Reserve Staff members believe that the economy grew at a moderate pace alongside increased consumer spending, higher exports and a continued upturn in business spending on equipment and software. However, the unemployment rate remains elevated and construction activity is still weak. On the inflation front, FOMC members expect that the inflation rate will continue to be below the level consistent with price stability and maximum employment, although the risk of deflation has receded somewhat. FOMC members see the housing sector, Europe and state and municipalities as risks and believe that there is no reason at present to change policy stance. We expect that the Fed will continue its current LSAP program as scheduled although the Fed will continue to monitor economic conditions. However, we also expect that over the course of the following meetings the Fed will begin to consider how to craft a communication strategy for either the end or the continuation of the LSAP program.

U.S. unemployment rate declined 0.4pp to 9.4% in December

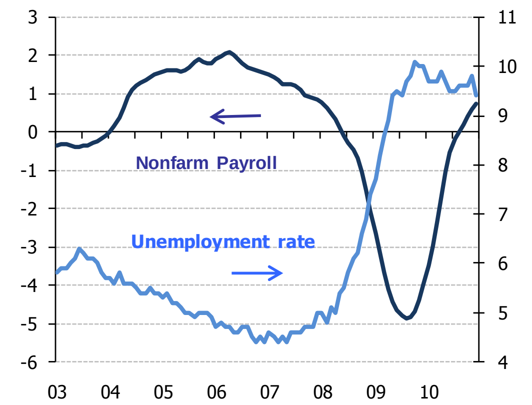
The Bureau of Labor Statistics (BLS) announced that in December the total nonfarm payroll rose 103K. Private payrolls continued to increase (113K), which was but significantly lower than the ADP employment report of a 297K increase. Private payrolls have increased in the last 12 consecutive months. Despite moderate increase in nonfarm payrolls, the unemployment rate declined 0.4pp to 9.4% partly due to a decline in the participation rate. The alternative unemployment rate, which includes those marginally attached to the workforce, also decreased 0.3pp to 16.7%. The median number of weeks unemployed continues to increase and reached 22.4. Among the unemployed, 44.5% are unemployed for the past 26 weeks, up from 41.8%, a sign of long-term unemployment. Furthermore, in December, the average weekly hours for all employees was 34.3 hours. The report supports our view that the unemployment rate will remain elevated even with moderate growth.

Graph 1
Non-farm Payroll (Monthly change, K)



Source: S&P

Graph 2
Unemployment (YoY % change, %)



Source: BLS

Week Ahead

Wholesale Inventories (November, Tuesday 10:00 ET)

Forecast: 1.1%	Consensus: 1.0%	Previous: 1.9%

Wholesale inventories rose 1.9% in October when markets were expecting a 0.9%increase. The September wholesale inventories were also revised up from 1.5% to 2.1%. Given that private inventories contributed 1.6pp of the 2.6 annualized growth in 3Q10, markets will watch closely wholesale inventories. Current trends indicate that wholesale inventories continued to increase in November.

Consumer Price Index, core (December, Friday 8:30 ET)

Forecast: 0.4%, 0.1%	Consensus: 0.4%, 0.1%	Previous: 0.1%, 0.1%

Both headline and core consumer price index increased by 0.1% in November on a seasonally adjusted basis. Headline consumer prices rose 1.1% in the last 12 months, a decline from 1.2%. The food and energy price indices rose 0.2% in November. The increase in the energy index is the smallest hike in the last five months. The 12-month increase in the energy index is 3.9%. The gasoline index hiked 7.3% while the household energy index dropped 0.2% in the same period. Housing prices increased by 0.1% in the last 12 months, the first increase since June 2009. The increase in energy prices, including oil, in the last month is likely to boost headline inflation.

Retail Sales, excluding auto (December, Friday 08:30 ET)

Forecast: 0.9%, 0.9%	Consensus: 0.8%, 0.7%	Previous: 0.8%, 1.2%

Retail sales increased by 1.0% on average in the last five months. Even excluding auto sales, retail sales rose 0.8% on average in the same period. Strong personal consumption, consumer sentiment and expectations point to strong retail sales in December. Therefore, we expect both total retail sales and retail sales excluding autos to increase by 0.9% in December. Possible improvements in labor markets and new tax cuts are also expected to support retail sales in the coming months.

Industrial Production (December, Friday 9:15 ET)

Forecast: 0.4%	Consensus: 0.5%	Previous: 0.4%

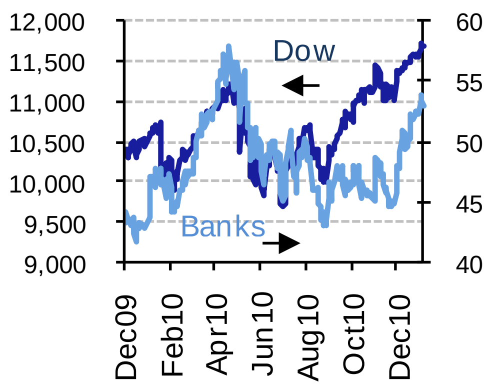
In November industrial production (IP) increased 0.4% following a 0.2% decline in the previous month. IP has increased in the last 17 months, except last October. While manufacturing production has increased in the last five months, production in the mining industry continued to decline. In addition, production in the utilities sector increased by 2.0% after declining three consecutive months. Consistent with the IP index, the total capacity utilization rate increased to 75.2% in November. While the capacity utilization rate in utilities rose 1.5pp to 78.4%, it declined 0.1pp to 88.7% in the mining industry in October. We expect that the IP index and total capacity utilization rate continued to increase moderately in December.

Market Impact

This week consumer prices and industrial production will get the most attention from market participants. Strong industrial production activity in December would imply that the U.S. economy grew faster than 2.7 in 2010. Although it is not expected, significant increase in core CPI would calm down discussions on deflationary risks. Moreover, strong retail sales would imply strong personal consumption expenditures and economic growth in 4Q10.

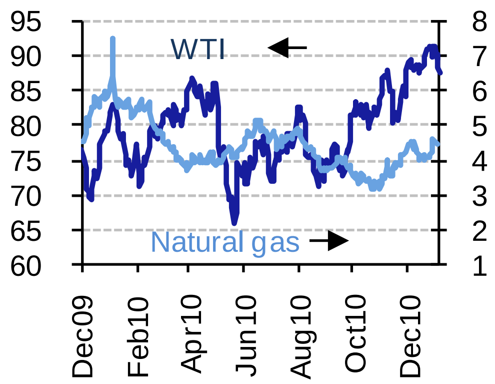
Financial Markets

Graph 3
Stocks (Index, KBW)



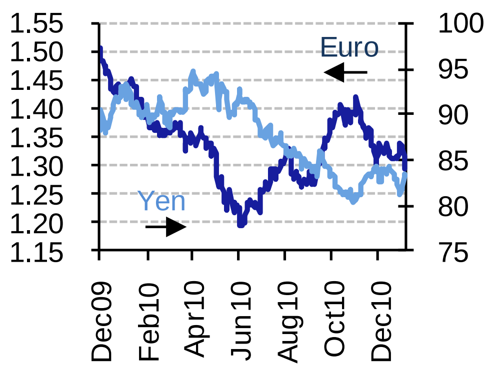
Source: Bloomberg & BBVA Research

Graph 4
Commodities (Dpb & DpMMBtu)



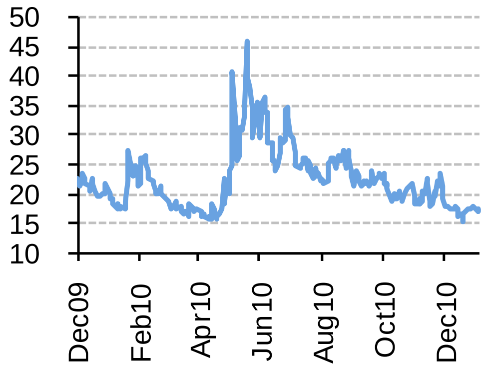
Source: Bloomberg & BBVA Research

Graph 5
Currencies (Dpe & Ypd)



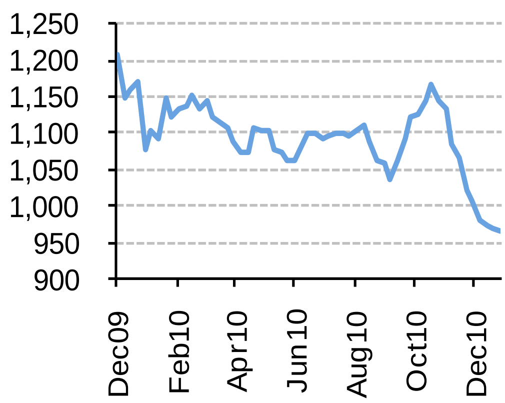
Source: Bloomberg & BBVA Research

Graph 6
Volatility (Vix, Index)



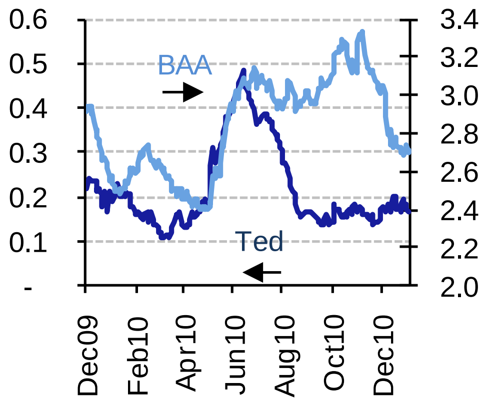
Source: Bloomberg & BBVA Research

Graph 7
Commercial Paper Issuance (US$Bn)



Source: Bloomberg & BBVA Research

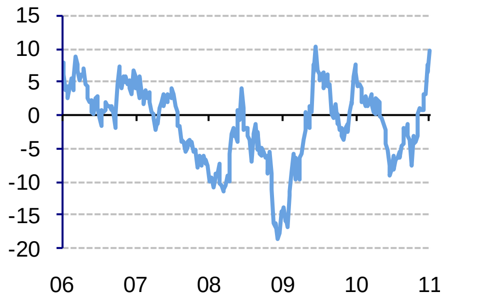
Graph 8
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

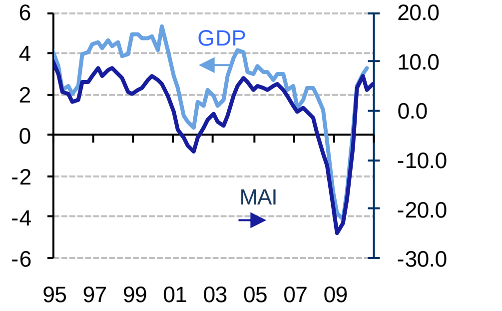
Economic Trends

Graph 9
BBVA US Weekly Activity Index (3 month % change)



Source: BBVA Research

Graph 10
BBVA US Monthly Activity Index & Real Gross Domestic Product (4Q % change)

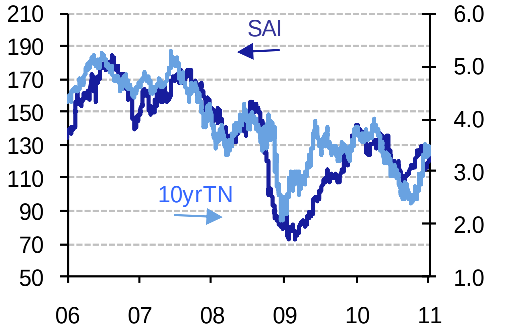


Source: BBVA Research & BEA

Graph 11
BBVA US Surprise Inflation Index (Index 2009=100)

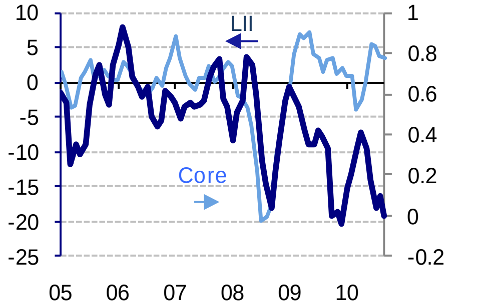
Source: BBVA Research

Graph 12
BBVA US Surprise Activity Index & 10-yr Treasury (Index 2009=100 & %)



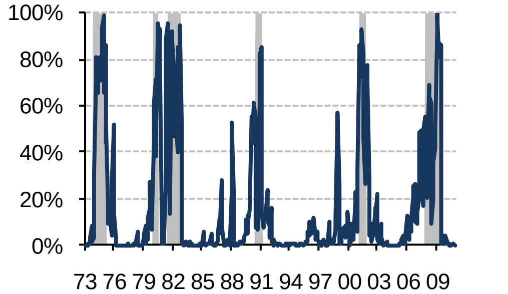
Source: Bloomberg & BBVA Research

Graph 13
BBVA US Leading Inflation Index & Core Inflation (Qoq % change)



Source: BLS & BBVA Research

Graph 14
BBVA US Recession Probability Model (Recession episodes in shaded areas,%)



Source: BBVA Research

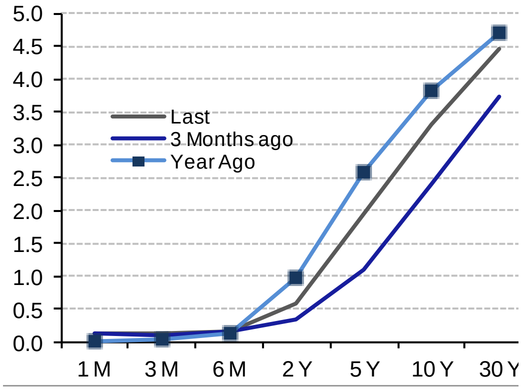
Yield Curve and Interest Rates

Table 1
Key Interest Rates, %

	Last	Week ago	4-Weeks ago	Year ago
Prime Rate	3.25	3.25	3.25	3.25
Credit Card (variable)	13.68	13.68	13.68	11.54
New Auto (36-months)	5.34	5.35	5.34	6.66
Heloc Loan 30K	5.47	5.50	5.51	5.69
30-year Fixed Mortgage *	4.77	4.86	4.61	5.09
Money Market	0.71	0.71	0.71	0.95
2-year CD	1.21	1.23	1.23	1.83
5-year CD	2.07	2.07	2.03	2.65

* Freddie Mac National Mortgage Homeowner Commitment 30 Year US
Source: Bloomberg and BBVA Research

Graph 15
Treasuries Yield Curve, %



Source: Bloomberg

Quote of the Week

Federal Reserve Chairman Ben S. Bernanke
January 7, 2011
Before the United States Senate Committee on the Budget
Washington, D.C.
"…the federal government is on an unsustainable fiscal path. Yet, as a nation, we have done little to address this critical threat to our economy. Doing nothing will not be an option indefinitely; the longer we wait to act, the greater the risks and the more wrenching the inevitable changes to the budget will be."

Economic Calendar

Date	Event		Forecast	Survey	Previous
11-Jan	Wholesale Inventories	NOV	1.1%	1.0%	1.9%
12-Jan	Import Price Index (MoM)	DEC	1.2%	1.2%	1.3%
12-Jan	Import Price Index (YoY)	DEC	4.7%	4.7%	3.7%
12-Jan	Fed's Beige Book	23-Apr	---	---	---
12-Jan	Monthly Budget Statement	DEC	-$87.0B	-$84.0B	-$91.4B
13-Jan	Initial Jobless Claims	8-Jan	399K	406K	409K
13-Jan	Continuing Claims	1-Jan	4080K	4090K	4103K
13-Jan	Producer Price Index (MoM)	DEC	0.8%	0.8%	0.8%
13-Jan	PPI Ex Food & Energy (MoM)	DEC	0.2%	0.2%	0.3%
13-Jan	Producer Price Index (YoY)	DEC	3.8%	3.8%	3.5%
13-Jan	PPI Ex Food & Energy (YoY)	DEC	1.4%	1.4%	1.2%
13-Jan	Trade Balance	NOV	-$38.0B	-$40.9B	-$38.7B
14-Jan	Consumer Price Index (MoM)	DEC	0.4%	0.4%	0.1%
14-Jan	CPI Ex Food & Energy (MoM)	DEC	0.1%	0.1%	0.1%
14-Jan	Consumer Price Index (YoY)	DEC	1.3%	1.3%	1.1%
14-Jan	CPI Ex Food & Energy (YoY)	DEC	0.7%	0.7%	0.8%
14-Jan	Advance Retail Sales	DEC	0.9%	0.8%	0.8%
14-Jan	Retail Sales Less Autos	DEC	0.9%	0.7%	1.2%
14-Jan	Industrial Production	DEC	0.4%	0.5%	0.4%
14-Jan	Capacity Utilization	DEC	75.4%	75.6%	75.2%
14-Jan	U. of Michigan Confidence	JAN P	76.0	75.5	74.5
14-Jan	Business Inventories	NOV	0.8%	0.7%	0.7%

Chief Economist for US and Mexico
Jorge Sicilia
J.Sicilia@bbva.bancomer.com

Chief Economist for US
Nathaniel Karp
Nathaniel.karp@bbvacompass.com

Ignacio San Martin
Ignacio.SanMartin@bbvacompass.com

Jeffrey Owen Herzog
Jeff.Herzog@bbvacompass.com

Marcial Nava
Marcial.Nava@bbvacompass.com

Hakan Danış
Hakan.Danis@bbvacompass.com

Jason Frederick
Jason.Frederick@bbvacompass.com

Contact details

BBVA Research
5 Riverway Drive
Houston, Texas 77056

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