

U.S.

# Weekly Watch

January 17, 2011

## Highlights

### Economic Analysis

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### The Consumer Prices

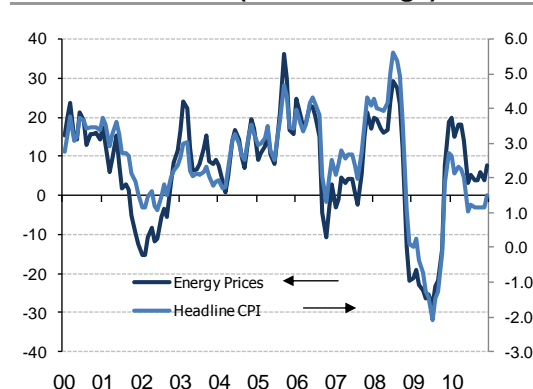
Last Friday, the Bureau of Labor Statistics (BLS) announced that headline and core consumer price indices increased 0.5% and 0.1%, respectively in December on a seasonally adjusted basis. Headline consumer prices rose 1.6% in 2010 while core consumer prices increased 1.0% in 2010. The release indicated that energy and food prices continued to rise in December. The energy index jumped 4.6% on a seasonally adjusted basis, driven by the gasoline index which hiked 8.5% and accounted for roughly 80% of the headline inflation. Gasoline and energy indices have risen in the last 6 months. Core consumer prices, all items less food and energy, also increased slightly in the same period. Among others, the shelter and housing price indices edged up slightly by 0.1% and 0.2%, respectively. Moreover, the indices for airline fares, medical care and apparel rose while the price indices for communication, recreation, and household furnishings and operations declined in December. In summary, headline consumer prices jumped significantly due to high energy prices in December. Although deflationary pressures remain elevated in core consumer prices, we expect that they will ease in the coming months since the report indicates that shelter prices will likely start contributing positively on a year-over-year basis in the coming months.

### Industrial Production

According to the Federal Reserve's estimate, U.S. industrial production (IP) rose 0.8% (market expectation = 0.4%) in December following 0.3% jump in November. IP has increased each of the past 18 months, except last October. Production in the manufacturing sector jumped 0.4%. Severe cold weather in December increased demand for utilities, and therefore the output of utilities soared 4.3% last month. Furthermore, although an increase in IP pushed the total capacity utilization rate up to 76.0%, it is still below its historical average. The capacity utilization rate in utilities jumped more than 3pp and reached 82.3%. Overall, the current upward trend in industrial production indicates that although the economic activity is improving, inflationary pressures are limited due to the low capacity utilization rate.

Graph 1

#### Consumer Prices (YoY % change)



Source: S&amp;P

Graph 2

#### Industrial Production (YoY % change)



Source: BLS

## Week Ahead

### Empire State Manufacturing Index (January, Tuesday 08:30 ET)

<b>Forecast: 12.0</b>	<b>Consensus: 13.0</b>	<b>Previous: 10.6</b>
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The Empire State Manufacturing (ESM) Index The ESM index dropped sharply below zero in November for the first time since July 2009. However, the index rebounded back and reached 10.57 in December indicating that regional business conditions are improving in manufacturing industry in New York State. We expect the ESM index to increase slightly in January, consistent with other regional manufacturing indices.

### Housing Starts (December, Wednesday 8:30 ET)

<b>Forecast: 560K</b>	<b>Consensus: 550K</b>	<b>Previous: 555K</b>
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Housing starts are expected to recover slightly in December. Housing demand is picking up from the last summer low sales, new home prices are now more stable and inventories of new homes have dropped to extremely low levels. All these factors create a more favorable environment for home builders. Nevertheless, construction remains at extremely low levels and housing starts are more than 60% below their historical average. This sector will continue to face challenges as existing homes are more affordable than new homes. As a result, existing home inventories need to decline before we see a strong recovery in housing starts.

### Initial Claims (Jan-15, Thursday 08:30 ET)

<b>Forecast: 430K</b>	<b>Consensus: 425K</b>	<b>Previous: 445K</b>
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The latest employment surveys show improvements in the labor market. The ADP employment report indicated that the private sector non-farm payrolls increased by 297K in December. This was the largest increase historically since the start of the survey which goes back to 2001. Private nonfarm payrolls, released by the BLS, indicated a moderate gain in employment in December. Private (total) nonfarm payrolls rose only 113K (103K). We expect that labor market conditions will continue to improve as the economic recovery progresses. We forecast a small decline in both initial and continuing claims.

### Existing Home Sales (December, Thursday 10:00 ET)

<b>Forecast: 4.76M</b>	<b>Consensus: 4.86M</b>	<b>Previous: 4.68M</b>
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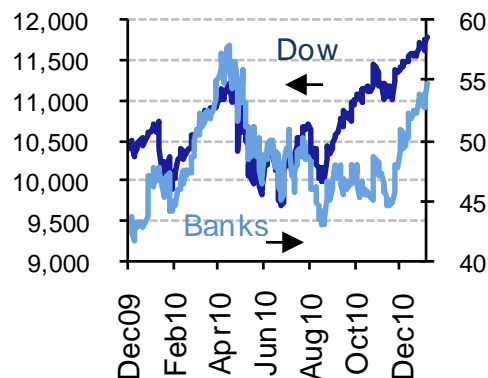
Existing home sales are expected to rise in December. Positive employment growth, improvements in housing affordability and consumer confidence are supporting existing home sales. Even though credit markets remain tight, historically low mortgage rates make home purchase attractive. Due to favorable current conditions and the expectation that both prices and mortgage rates will increase in the future, sales of existing homes are likely to rise. However, the inventory to sales ratio for existing homes (the number of months required to sell the existing inventory) for the past few months is still well above the historical average of 5.8 months, which indicates that prices will not appreciate significantly in the short term.

### Market Impact

Recent economic indicators point to robust economic activity in 4Q10. This week's releases are more related to real estate markets and they will add insight to the current situation in the real estate market. If housing starts and existing home sales come better-than-expected, markets will expect stronger growth in 4Q10.

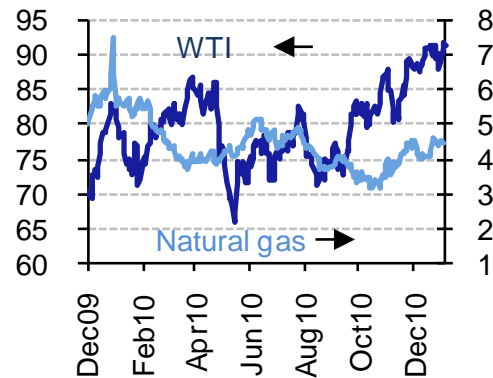
# Financial Markets

Graph 3  
**Stocks (Index, KBW)**



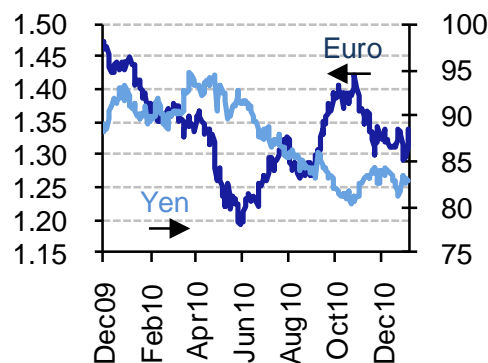
Source: Bloomberg & BBVA Research

Graph 4  
**Commodities (Dpb & DpMMBtu)**



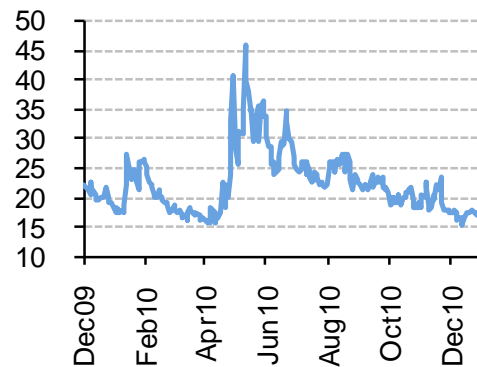
Source: Bloomberg & BBVA Research

Graph 5  
**Currencies (Dpe & Ypd)**



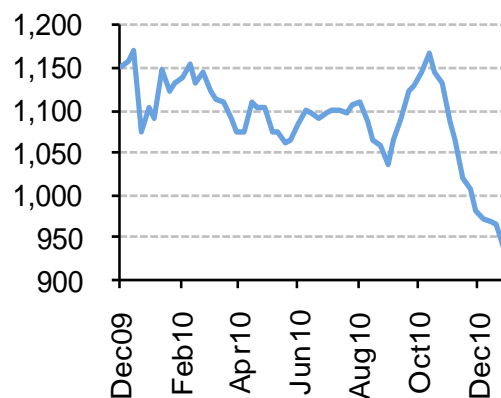
Source: Bloomberg & BBVA Research

Graph 6  
**Volatility (Vix, Index)**



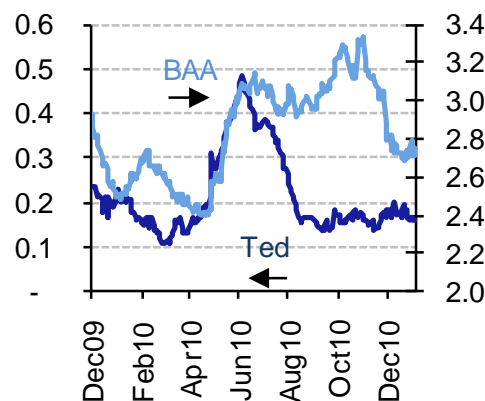
Source: Bloomberg & BBVA Research

Graph 7  
**Commercial Paper Issuance (US\$Bn)**



Source: Bloomberg & BBVA Research

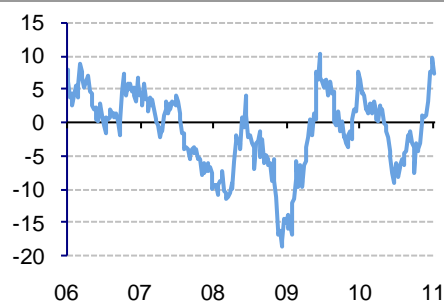
Graph 8  
**TED & BAA Spreads (%)**



Source: Bloomberg & BBVA Research

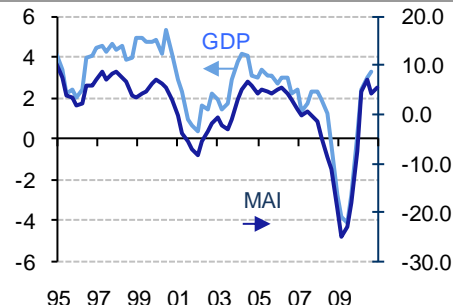
## Economic Trends

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)**



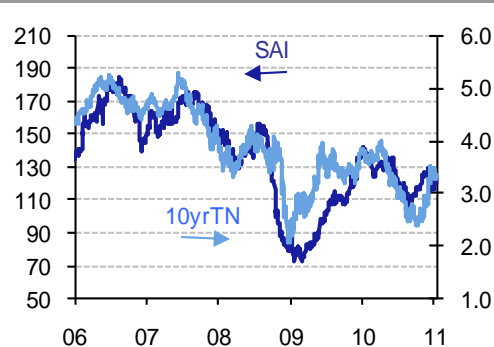
Source: BBVA Research & BEA

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



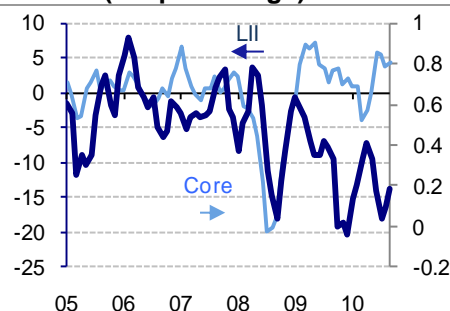
Source: BBVA Research

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



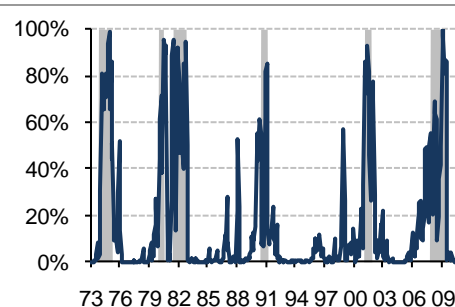
Source: Bloomberg & BBVA Research

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

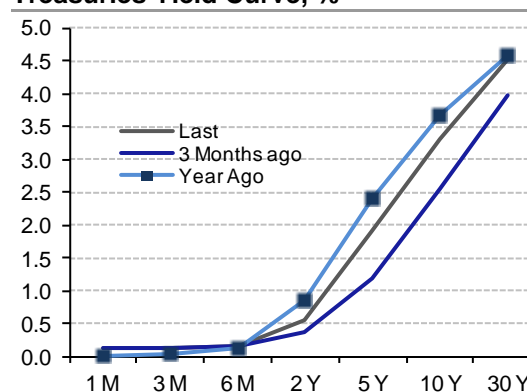
### Key Interest Rates, %

	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	11.61
New Auto (36-months)	5.09	5.34	5.33	6.49
Heloc Loan 30K	5.55	5.47	5.49	5.67
30-year Fixed Mortgage *	4.71	4.77	4.83	5.06
Money Market	0.71	0.71	0.71	0.90
2-year CD	1.31	1.21	1.23	1.79
5-year CD	2.06	2.07	2.03	2.69

\* 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 Bank of Minneapolis President Narayana Kocherlakota

January 11, 2011

It's a Wonderful Fed

Wisconsin Bankers Association

Madison, Wisconsin

*"I expect that real output will grow slightly more rapidly in 2011 than in 2010. Household deleveraging and bank asset quality will remain a drag on the recovery. Unemployment will fall—but much more slowly than we would like. Finally,... I am optimistic that we will see some re-inflation in the coming year."*

## Economic Calendar

Date	Event		Forecast	Survey	Previous
18-Jan	Empire Manufacturing	JAN	12.0	13.0	10.6
18-Jan	NAHB Housing Market Index	JAN	17.0	17.0	16.0
19-Jan	Housing Starts	DEC	560K	550K	555K
19-Jan	Building Permits	DEC	560K	555K	544K
19-Jan	Housing Starts MOM%	DEC	0.9%	-0.9%	3.9%
19-Jan	Building Permits MOM%	DEC	2.9%	2.0%	-1.4%
20-Jan	Initial Jobless Claims	15-Jan	430K	425K	445K
20-Jan	Continuing Claims	8-Jan	3870K	3985K	3879K
20-Jan	Existing Home Sales	DEC	4.76M	4.86M	4.68M
20-Jan	Existing Home Sales MoM	DEC	1.7%	3.8%	5.6%
20-Jan	Leading Indicators	DEC	0.8%	0.6%	1.1%
20-Jan	Philadelphia Fed.	JAN	21.0	20.4	20.8

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