

U.S.

# Weekly Watch

February 21, 2011

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## Highlights

### CPI

The Bureau of Labor Statistics (BLS) announced that January headline and core consumer price indices increased by 0.4% and 0.2%, respectively (market expectations = 0.3% and 0.1%) on a seasonally adjusted basis. The main drivers of the increase in headline consumer prices were energy, commodities and food prices, similar to previous month. The increase in these prices accounted for more than two thirds of the total increase. On a month-over-month (MoM) basis, core inflation was the highest since October 2009. The report showed that the food and beverages price index rose 1.8% over the last 12 months. The core CPI, the index for all items less food and energy, increased 0.2% MoM in January. The indices for shelter, rent, and owners' equivalent rent continued to increase. The housing price index, which accounts for more than 40% of headline CPI, increased for the fourth consecutive month on a MoM basis and increased for the first time on a YoY basis. Furthermore, airline fares, recreation and medical care prices climbed last month. On the other hand, the indices for new and used vehicles declined in January. In summary, consumer prices increased more than market expectations. Although the main drivers of January inflation were higher energy, commodities and food prices, current trends in core inflation indicate that the probability of a deflation is very low. We believe that inflation will increase slightly but remain low in 2011 compared to its historical average.

### The President's 2012 Budget Proposal Projects \$1.1tr Deficit

Last Monday, President Obama announced the U.S. budget for 2012 that cuts military spending, freezes non-security discretionary spending and Federal civilian worker pay for 2 years. It also eliminates tax credits for oil, gas and coal companies, eliminates all earmarks, and cuts or consolidates many government programs. The proposal also introduces a Financial Crisis Responsibility Fee which will be charged to financial firms with assets over \$50bn, but gives incentives for Research and Development (R&D), clean energy, and spending on high-speed rail and wireless infrastructure. The budget suspends States' interest payments on their debt owed to the federal government for two years to give some room for the States to pay their debt and reduces investment portfolios and loans guaranteed by Fannie Mae and Freddie Mac. Therefore, the budget plans to diminish government involvement in the mortgage market gradually over time. If the proposal is enacted, the U.S. budget deficit is expected to be \$1.1tr in 2012. Under the Administration's economic growth assumptions the budget deficit will decline to 3.6% in 2014 and reach 2.9% in 2018. The proposed budget leaves structural problems in Medicaid and Medicare programs for future negotiations and calls for corporate tax reform. President Obama acknowledges these issues and expects that both parties would continue debating on a solution for these long-term problems.

## Week Ahead

### Case-Shiller 20-city Index (December, Tuesday 09:00 ET)

<b>Forecast: -1.78%</b>	<b>Consensus: -2.3%</b>	<b>Previous: -1.59%</b>
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Housing prices in December will decline slightly and remain below those of last year, indicating a year-over-year change of -1.8%. As demand for homes is strengthening and inventories are shrinking, home prices will stabilize further in coming months. Positive employment growth, increasing family income and low mortgage rates will continue to stimulate the demand. However, the housing market remains weak and there is some uncertainty as the current high number of foreclosures and limited access to credit will limit house price appreciation in 2011.

### Existing Home Sales (January, Wednesday 10:00 ET)

<b>Forecast: 5.35M</b>	<b>Consensus: 5.20M</b>	<b>Previous: 5.28M</b>
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Existing home sales are expected to increase in January, as indicated by the 2% increase in pending home sales. Market conditions continue to favor the buyer as home prices and mortgage rates are low and affordability levels are high. Looking at historical data, the inventory to sales ratio for existing homes (the number of months required to sell the existing inventory) for the past few months has decreased from 10.5 to 8.1 months. Market conditions continue to favor the buyer as home prices and mortgage rates are low and affordability levels are high. These conditions will help to support home sales moving forward.

### Durable Goods Orders (January, Thursday 08:30 ET)

<b>Forecast: 2.5%</b>	<b>Consensus: 3.0%</b>	<b>Previous: -2.5%</b>
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After declining in the previous three months, durable goods orders are expected to climb in January. Upward trend in both consumer and business confidence point is expected to boost investment and consumer demand in 2011. With better business conditions, we expect durable goods orders to increase significantly in 1Q11.

### Real Gross Domestic Product (Q410 Second Estimate, Friday 08:50 ET)

<b>Forecast: 3.3%</b>	<b>Consensus: 3.3%</b>	<b>Previous: 3.2%</b>
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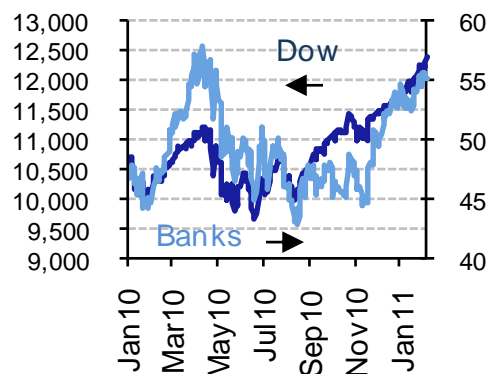
The US economy grew 3.2% (q/q, annualized) according to the Bureau of Economic Analysis' (BEA) advance estimate. PCE jumped 4.4% in 4Q10 and contributed 3.04pp to real Gross Domestic Product (GDP) growth. However, gross private investment declined dramatically due to weak inventories data and a slowdown in nonresidential investment. The change in total inventories declined from \$121.4bn to \$7.2bn and contributed -3.7pp to real GDP growth. While the contribution of net exports was 3.4pp to GDP growth in 4Q10, the latest international trade statistics point to stronger contribution of net exports. Therefore, we expect a slight upward revision to 4Q10 real GDP. We also expect a slight downward revision to PCE. The BEA's final estimate of GDP will be released on March 25, 2011.

### Market Impact

Any revision to 4Q10 GDP would have little impact on the financial markets while significant declines in home prices and sales would highlight the ongoing weakness in the residential industry. On the contrary, if durable goods orders soar as expected, it would be an important sign for strong economic activity in 1Q11.

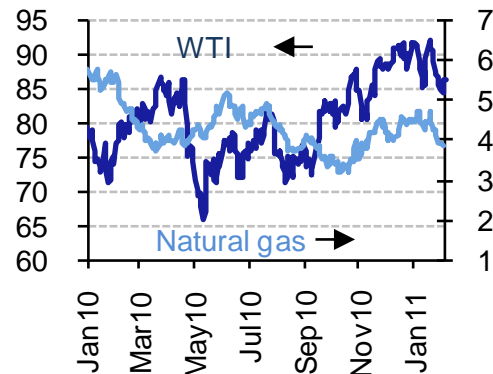
## Financial Markets

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



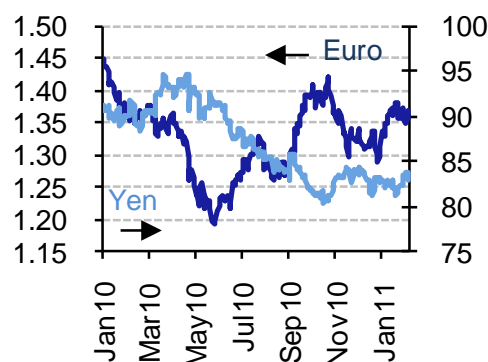
Source: Bloomberg & BBVA Research

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



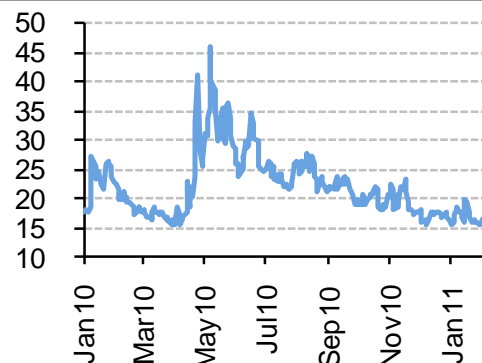
Source: Bloomberg & BBVA Research

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



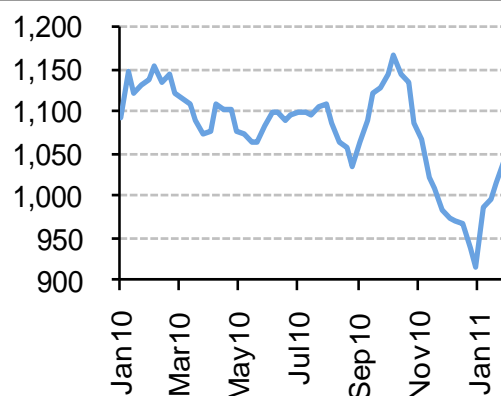
Source: Bloomberg & BBVA Research

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



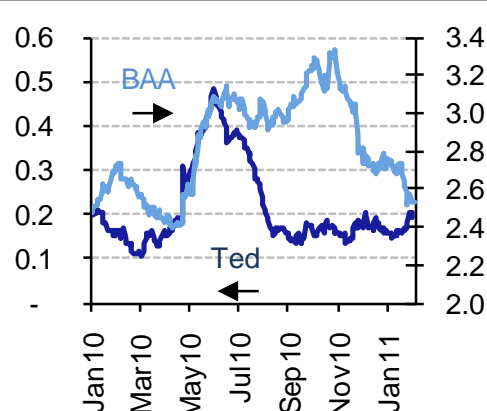
Source: Bloomberg & BBVA Research

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



Source: Bloomberg & BBVA Research

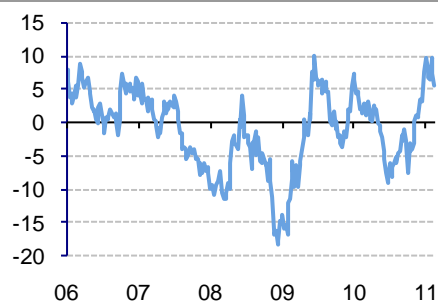
Graph 8  
**TED & BAA Spreads (%)**



Source: Bloomberg & BBVA Research

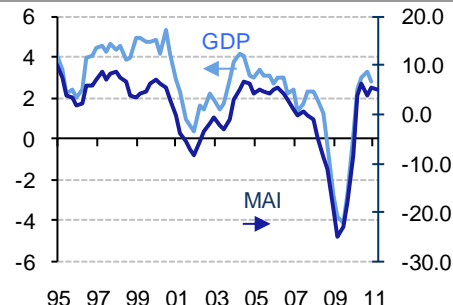
# Economic Trends

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)**



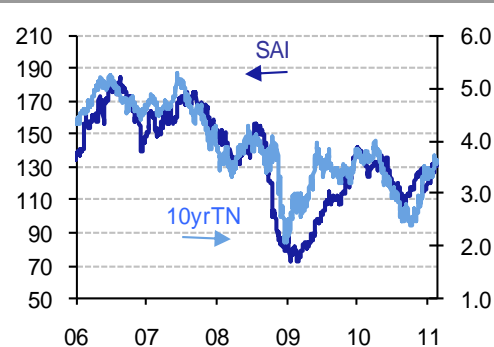
Source: BBVA Research & BEA

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



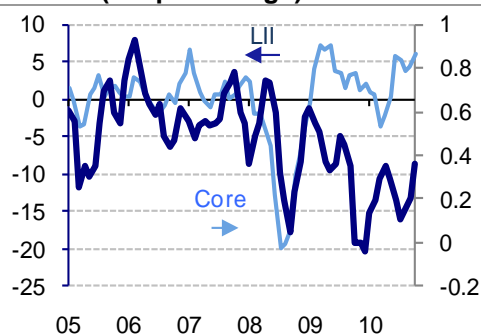
Source: BBVA Research

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



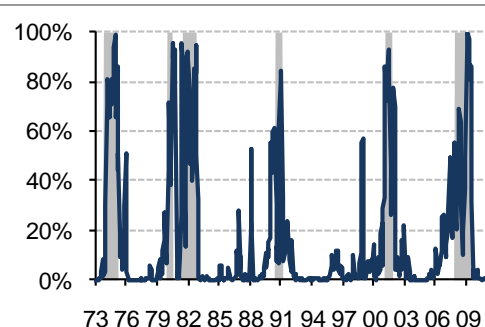
Source: Bloomberg & BBVA Research

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

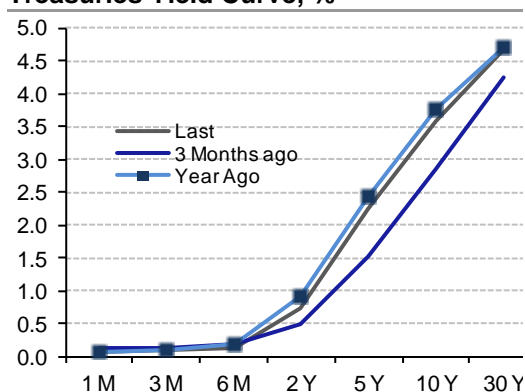
## Yield Curve and Interest Rates

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)	13.73	13.71	13.68	12.53
New Auto (36-months)	5.06	5.07	5.10	6.27
Heloc Loan 30K	5.55	5.54	5.56	5.71
30-year Fixed Mortgage *	5.00	5.05	4.74	4.93
Money Market	0.63	0.65	0.71	0.85
2-year CD	1.29	1.31	1.31	1.74
5-year CD	2.06	2.06	2.07	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 Bernanke  
February 18, 2011  
Banque de France Financial Stability Review  
Paris, France

*"Our collective challenge is to reshape the international monetary system to foster strong, sustainable growth and improve economic outcomes for all nations."*

## Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
22-Feb	S&P/CS 20 City MoM% SA	DEC	-0.5%	-0.5%	-0.5%
22-Feb	S&P/CS Composite-20 YoY	DEC	-1.8%	-2.4%	-1.6%
22-Feb	Consumer Confidence	FEB	66.0	65.0	65.6
22-Feb	Richmond Fed Manufact. Index	FEB	20.0	18.0	18.0
23-Feb	Existing Home Sales	JAN	5.35M	5.20M	5.28M
23-Feb	Existing Home Sales MoM	JAN	1.3%	-1.5%	12.3%
24-Feb	Chicago Fed Nat Activity Index	JAN	0.2	0.2	0.0
24-Feb	Initial Jobless Claims	19-Feb	405K	405K	410K
24-Feb	Continuing Claims	12-Feb	3900K	3880K	3911K
24-Feb	Durable Goods Orders	JAN	2.5%	3.0%	-2.3%
24-Feb	Durables Ex Transportation	JAN	0.5%	0.5%	0.8%
24-Feb	New Home Sales	JAN	335K	300K	329K
24-Feb	New Home Sales MoM	JAN	1.8%	-8.8%	17.5%
24-Feb	House Price Purchase Index QoQ	4Q	-0.1%	-1.5%	-1.6%
24-Feb	House Price Index MoM	DEC	1.6%	-0.1%	0.0%
25-Feb	GDP QoQ (Annualized)	4Q S	3.3%	3.3%	3.2%
25-Feb	GDP Price Index	4Q S	0.3%	0.3%	0.3%
25-Feb	Core PCE QoQ	4Q S	0.4%	0.4%	0.4%
25-Feb	Personal Consumption	4Q S	4.2%	4.2%	4.4%
25-Feb	U. of Michigan Confidence	FEB F	75.0	75.4	75.1

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