

U.S. Weekly Watch

March 14, 2011

Highlights

Economic Analysis

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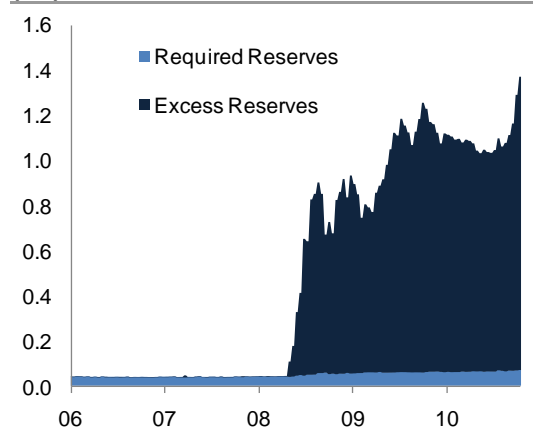
New Record High Excess Reserves Pose Risk to Policy

Latest data on the Federal Reserve's balance sheet reveals that depository institutions are adding excess reserves at the fastest pace since the months surrounding the Lehman Brothers bankruptcy. Since January 5, 2010, reserve balances have increased by \$356bn, most of which occurred after February. Possible drivers for the rise in excess reserves may include recent increases in implied volatility and higher implied 5-year spot inflation rates. Government securities purchases by commercial banks have been flat since the beginning of 2011 after a substantial rise of around \$200bn over the course of last year. The Fed is purchasing securities in the secondary markets and banks keep adding more reserves at the Fed instead of conducting long-term investments. This will make the exit strategy from extraordinary monetary policy increasingly difficult.

Retail Sales Soared in February

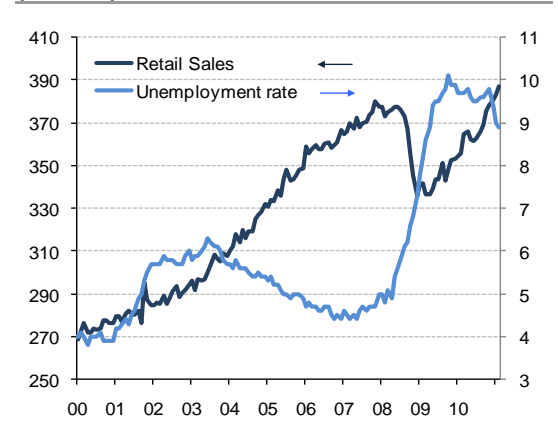
Last week, the U.S. Department of Commerce (USDC) announced that advance estimates of U.S. retail and food services sales for February jumped 1.0% from the previous month. USDC also revised its previous estimate of January retail sales by 0.4pp. Advance estimates indicate that U.S. consumers spent \$387.1bn for retail and food services, an increase of 8.9% from Feb 2010. Furthermore, auto and other motor vehicle dealer sales climbed 25.9% in the last 12 months while gasoline station sales spiked 12.9% from last year due to higher oil prices. Although the main drivers of this jump are auto purchases and an increase in gas prices, excluding these items retail sales increased by 0.6% MoM. The upward trend in retail sales is also consistent with recent gains in employment. Total nonfarm payroll rose 192K and the unemployment rate declined to 8.9% last month. In sum, although a significant portion of the recent upward trend in retail sales is related to higher oil prices and consumer prices, February retail sales indicate that the upward trend in personal spending will continue in 1Q11.

Graph 1
Excess and Required Reserves (\$tr)



Source: Federal Reserve

Graph 2
Retail Sales & Unemployment Rate (\$bn, %)



Source: US Census Bureau and BLS

Week Ahead

FOMC Meeting (Mar-15, Tuesday 14:15 ET)

Forecast: 0%-0.25%	Consensus: 0%-0.25%	Previous: 0%-0.25%
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The FOMC will meet on March 15 for the second time in 2011. We expect no significant changes in monetary policy and the after-meeting FOMC statement. Even though economic indicators continue to show signs of strong recovery, economic slack is still prevalent. Although labor market conditions are improving, job creation is lagging the economic recovery. Furthermore, a surge in oil prices is pushing headline prices higher, but the pass-through to core prices remains limited. Although some officials are more concerned with potential mid-term inflationary pressures, it is too early to expect rate hikes. Therefore, we expect the Fed will keep the federal funds rate unchanged.

Housing Starts (February, Wednesday 08:30 ET)

Forecast: 580K	Consensus: 575K	Previous: 596K
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Housing starts are expected to decrease slightly in February. Although new home inventory is at historically low levels, poor new home sales and low confidence levels will lead home builders to lower housing activity. Indeed, building permits for single family homes decreased slightly in January, which could foreshadow a lower number of housing starts in February. In addition, foreclosures are still occurring and the inventory to sales ratio remains high, which could discourage housing starts. However, as employment keeps growing and households income rising, in an environment of very low mortgage rates, housing demand for new homes will increase as well as building activity.

Consumer Price Index (February, Thursday 08:30 ET)

Forecast: 0.4%, 0.1%	Consensus: 0.4%, 0.1%	Previous: 0.4%, 0.2%
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In January headline and core consumer prices increased by 0.4% and 0.2%, respectively, on a seasonally adjusted basis. Similar to the previous month, the main drivers of the increase in headline consumer prices were energy, commodities and food prices which accounted for more than two-thirds of the total price increase. 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 first time on a YoY basis after declining for 18 consecutive months. The expected pass-through from commodity, energy and food to core prices in February is expected to be limited. Therefore, we expect consumer prices to increase at a rate similar to previous month.

Industrial Production (February, Thursday 09:15 ET)

Forecast: 0.7%	Consensus: 0.6%	Previous: -0.1%
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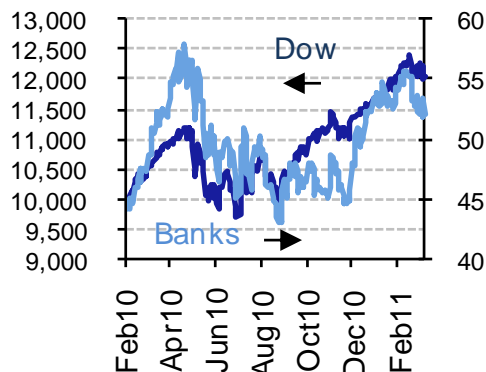
Industrial production declined 0.1% in January and surprised the markets on the downside. Recent trends support our view that industrial production will jump significantly in February. In the previous month, while material prices dropped 0.3%, final products climbed 1.1% on a MoM basis. Despite economic recovery since mid-2009, capacity utilization remains far away from full capacity. Total capacity utilization was 76.1% in January, mainly due to excess capacity in the manufacturing industry. We expect that total capacity utilization will reach 76.4% in February.

Market Impact

A significant jump in core prices would may prompt signs of inflationary pressures and increase inflation premia in fixed-income markets.

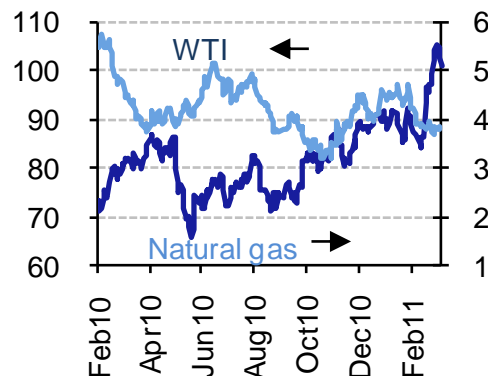
Financial Markets

Graph 3
Stocks (Index, KBW)



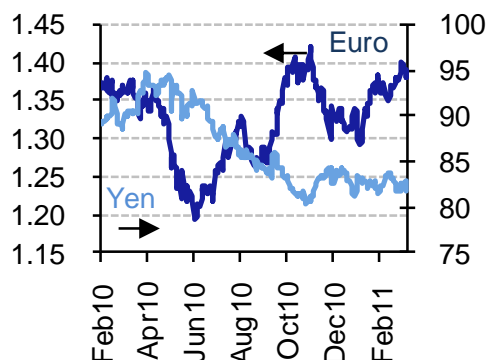
Source: Bloomberg & BBVA Research

Graph 4
Commodities (Dpb & DpMMBtu)



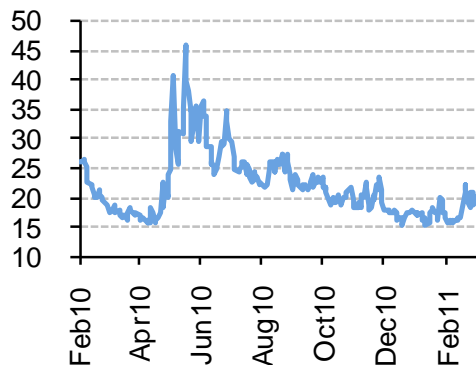
Source: Bloomberg & BBVA Research

Graph 5
Currencies (Dpe & Ypd)



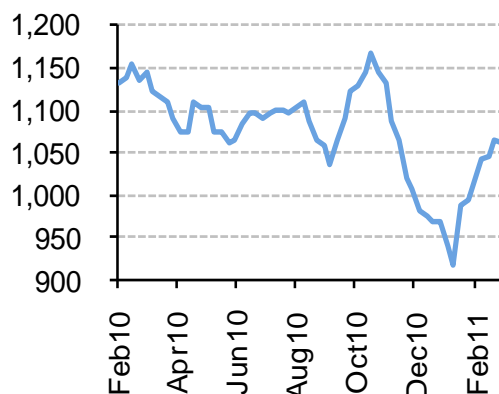
Source: Bloomberg & BBVA Research

Graph 6
Volatility (Vix, Index)



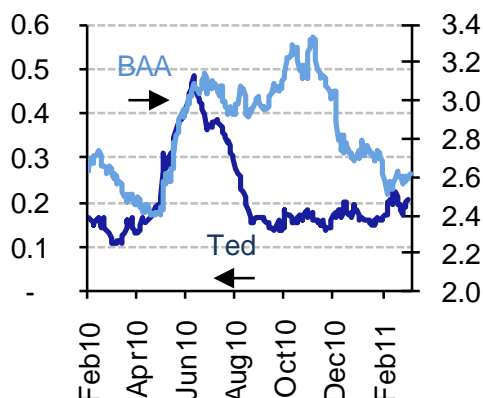
Source: Bloomberg & BBVA Research

Graph 7
Commercial Paper Issuance (US\$Bn)



Source: Bloomberg & BBVA Research

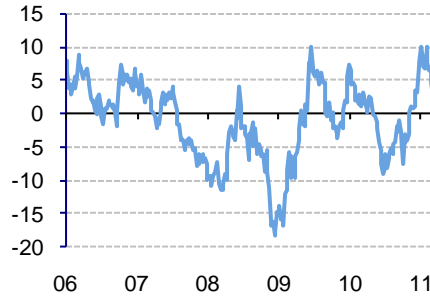
Graph 8
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

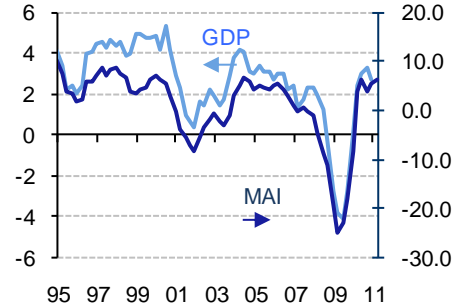
Economic Trends

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



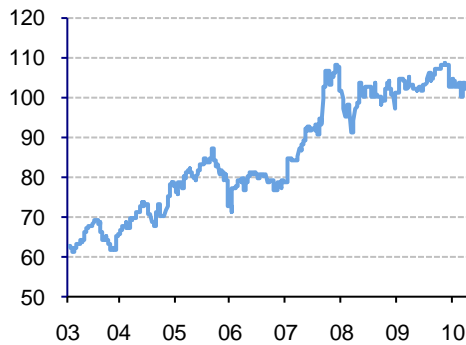
Source: BBVA Research

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



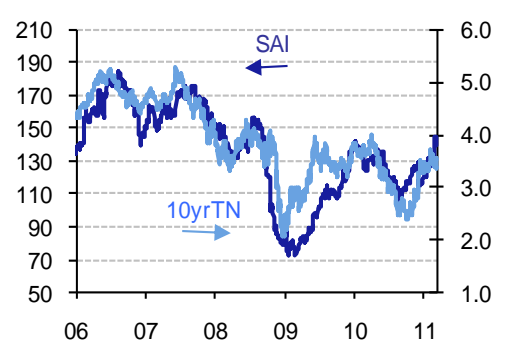
Source: BBVA Research & BEA

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



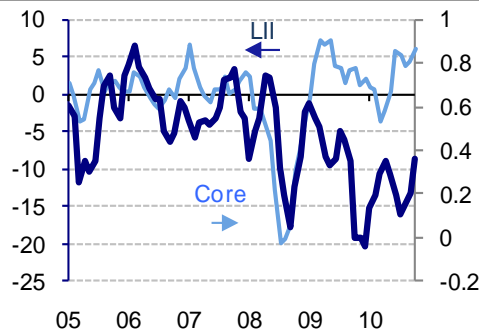
Source: BBVA Research

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



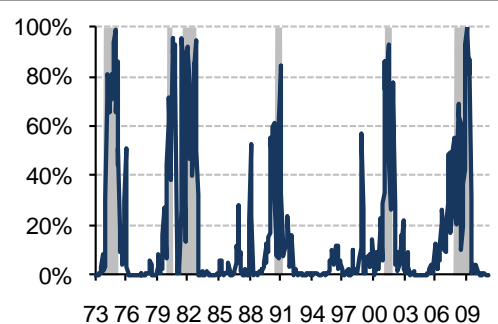
Source: Bloomberg & BBVA Research

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

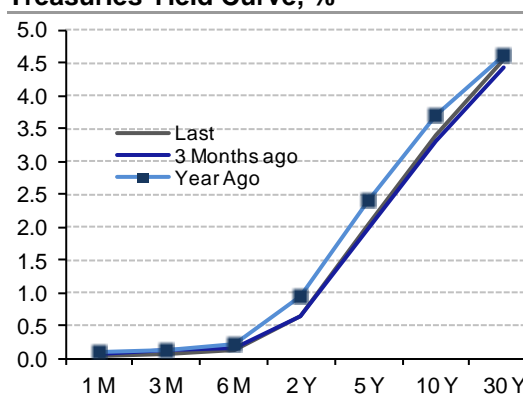
Yield Curve and Interest Rates

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	13.73	13.71	12.55
New Auto (36-months)	4.80	5.02	5.07	6.44
Heloc Loan 30K	5.48	5.53	5.54	5.70
30-year Fixed Mortgage *	4.88	4.87	5.05	4.95
Money Market	0.61	0.63	0.65	0.81
2-year CD	1.28	1.28	1.31	1.66
5-year CD	2.06	2.06	2.06	2.60

* 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 New York President William C. Dudley
March 11, 2011
Before the Queens Chamber of Commerce
Queens, N.Y.

"A stronger recovery with more rapid progress toward our dual mandate objectives is what we have been seeking. This is welcome and not a reason to reverse course."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
15-Mar	Empire Manufacturing	MAR	15.0	16.0	15.4
15-Mar	Import Price Index (MoM)	FEB	1.0%	0.9%	1.5%
15-Mar	NAHB Housing Market Index	MAR	17.0	17.0	16.0
15-Mar	FOMC Rate Decision	15-Mar	0.25%	0.25%	0.25%
16-Mar	Housing Starts	FEB	580K	575K	596K
16-Mar	Building Permits	FEB	582K	570K	563K
16-Mar	Producer Price Index (MoM)	FEB	0.7%	0.6%	0.8%
16-Mar	PPI Ex Food & Energy (MoM)	FEB	0.2%	0.2%	0.5%
16-Mar	Current Account Balance	4Q	-\$114.0B	-\$110.0B	-\$127.2B
17-Mar	Consumer Price Index (MoM)	FEB	0.4%	0.4%	0.4%
17-Mar	CPI Ex Food & Energy (MoM)	FEB	0.1%	0.1%	0.2%
17-Mar	Consumer Price Index (YoY)	FEB	2.0%	2.0%	1.6%
17-Mar	CPI Ex Food & Energy (YoY)	FEB	1.0%	1.0%	1.0%
17-Mar	Initial Jobless Claims	12-Mar	380K	385K	397K
17-Mar	Continuing Claims	5-Mar	3745K	3750K	3771K
17-Mar	Industrial Production	FEB	0.7%	0.6%	-0.1%
17-Mar	Capacity Utilization	FEB	76.4%	76.5%	76.1%
17-Mar	Leading Indicators	FEB	0.8%	0.9%	0.1%
17-Mar	Philadelphia Fed.	MAR	32.0	30.0	35.9

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