

U.S.

Weekly Watch

March 21, 2011

Economic Analysis

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Highlights

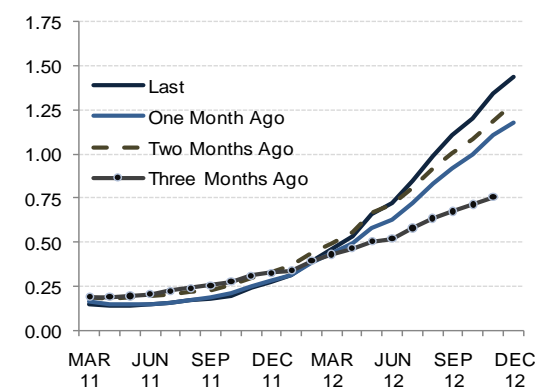
The Fed believes that recent oil price increases are transitory

The Federal Open Market Committee (FOMC) released a statement last week indicating the Fed will continue pursuing a combination of extremely low interest rates and large-scale asset purchases (LSAPs) to combat below-mandate inflation and employment. While the statement highlighted that labor market conditions are on a “firmer footing,” the statement continued to be sanguine about unemployment, nonresidential structures investment and the housing sector. The committee believes that recent oil price increases are transitory, therefore posing no long-term threat to price stability. The Fed decided to continue its implementation of LSAP as planned but will continue to monitor economic and financial conditions and adjust the program as necessary. As a result, the FOMC maintained the Fed Funds rate at 0 to .25 percent. Given international events such as the earthquake in Japan, oil shocks surrounding political events in the Middle East and North Africa, and subsequent financial market frictions, we now believe it is less likely that the next statement in April will contain substantial changes. Overall, the statement is consistent with our expectations of no rate hikes in 2011.

Consumer Prices Continued to Increase in February

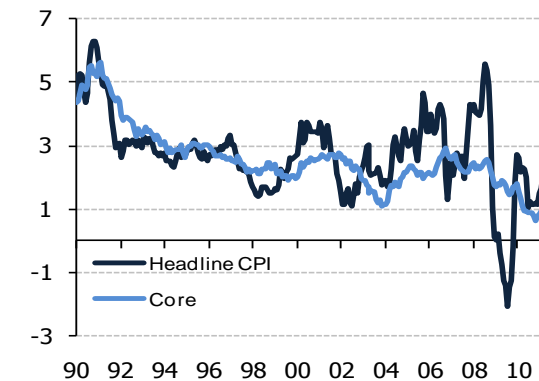
The Bureau of Labor Statistics announced that both headline and core consumer price indices increased by 0.5% and 0.2% MoM in February, respectively on a seasonally adjusted basis. It is the largest monthly increase in headline prices since June 2009. The main drivers of February inflation were energy and food prices, mainly due to higher oil and commodity prices. The price index for energy commodities jumped 19.3% YoY while the price index for energy services increased only by 0.2%. Moreover, within core price indices, all but the apparel index increased last month. Shelter prices are also no longer a drag to core inflation. Shelter prices have increased by 0.1% MoM on average in the last five consecutive months. On a YoY basis, headline and core consumer prices are up 2.1% and 1.1%, respectively. Overall, pass-through effect from higher energy prices to core prices remained limited. The current levels are still within the Fed's comfort zone and therefore, we do not expect any rate hikes in 2011.

Graph 1
Fed Funds Expectations
(Futures Contract End, %)



Source: Bloomberg and BBVA Research

Graph 2
Consumer Price Indices
(YoY % change)



Source: BLS

Week Ahead

Existing Home Sales (February, Monday 10:00 ET)

| | | |
|------------------------|-------------------------|------------------------|
| Forecast: 5.15M | Consensus: 5.11M | Previous: 5.36M |
|------------------------|-------------------------|------------------------|

Existing home sales are expected to drop in February, as indicated by the 3% decline in pending home sales. The strong growth in home sales in the previous two months was inflated by the high volume of foreclosures and short sales, which have declined significantly in February. Indeed, foreclosure filings were reported on 225,101 properties in February, a 14 percent decrease from the previous month and a 27 percent decrease year over year, according to RealtyTrac. Nevertheless, 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.

Initial Jobless Claims (March-19, Thursday 08:30 ET)

| | | |
|-----------------------|------------------------|-----------------------|
| Forecast: 375K | Consensus: 383K | Previous: 385K |
|-----------------------|------------------------|-----------------------|

Labor market conditions are improving gradually. In the previous three months, the unemployment rate dropped by 0.9 basis points from 9.8% to 8.9% and the private sector created 222K new jobs in February. As a result, applications for jobless insurance claims have been declining. In particular, the 4-week moving average of initial claims is at 386K, the lowest level since July 2008. We expect that the gradual improvement in labor markets will continue and therefore, we expect slight decline in both initial and continuing jobless claims this week.

Durable Goods Orders (February, Thursday 08:30 ET)

| | | |
|-----------------------|------------------------|-----------------------|
| Forecast: 0.5% | Consensus: 1.0% | Previous: 3.2% |
|-----------------------|------------------------|-----------------------|

In January, new orders in durable goods jumped 3.2% MoM, following three months of decline. However, when transportation equipment, which includes non-defense airplanes, is excluded, new orders declined 3.0%. In other words, the increase in durable goods orders in January came from the volatile nondefense aircraft and parts, which soared 5,137% MoM. We expect new orders in durable goods to continue increasing in February but at a slower pace.

Real Gross Domestic Product (Third Estimate - 4Q10, Friday 08:30 ET)

| | | |
|-----------------------|------------------------|-----------------------|
| Forecast: 2.9% | Consensus: 3.0% | Previous: 2.8% |
|-----------------------|------------------------|-----------------------|

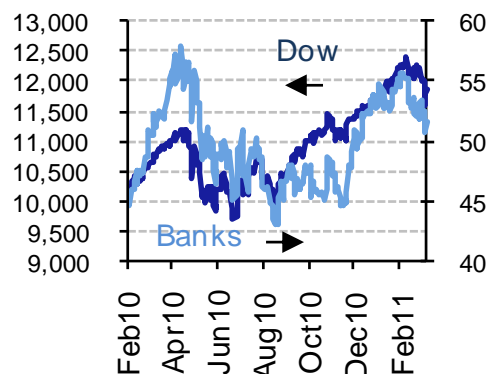
We expect the Bureau of Economic Analysis to revise up its 4Q10 real GDP growth estimate. Although the international trade report indicates a larger trade gap and therefore slower economic growth, better-than-expected business investment and wholesale inventories point to a slight upward revision to 4Q10 estimate.

Market Impact

Labor market conditions are improving faster than expected and this week's initial jobless claims will provide more information as to whether this trend will continue in March. If initial claims drop below 365K, it would imply fewer layoffs and a significant improvement in labor market conditions. Moreover, stronger-than-expected durable goods orders would point to stronger economic activity in the months ahead and, therefore it would also positively affect financial markets.

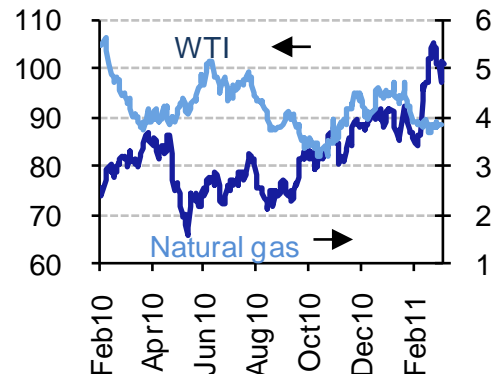
Financial Markets

Graph 3
Stocks (Index, KBW)



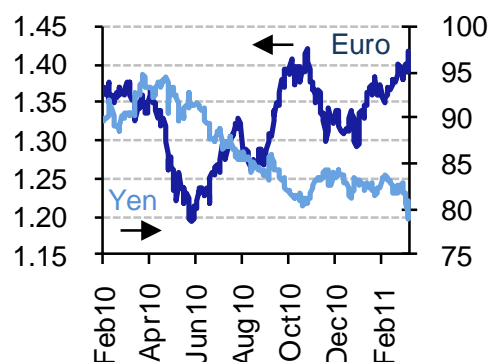
Source: Bloomberg & BBVA Research

Graph 4
Commodities (Dpb & DpMMBtu)



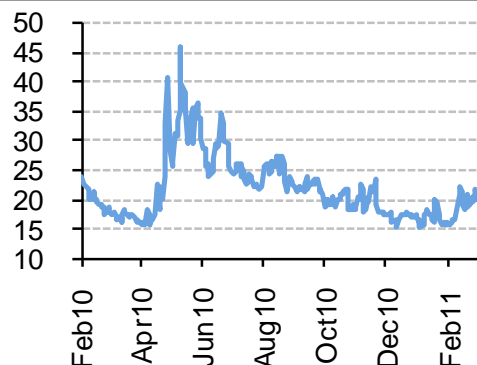
Source: Bloomberg & BBVA Research

Graph 5
Currencies (Dpe & Ypd)



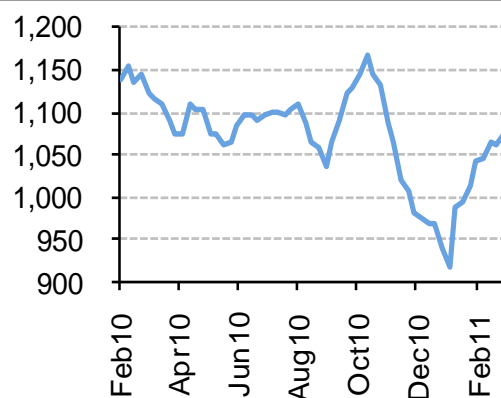
Source: Bloomberg & BBVA Research

Graph 6
Volatility (Vix, Index)



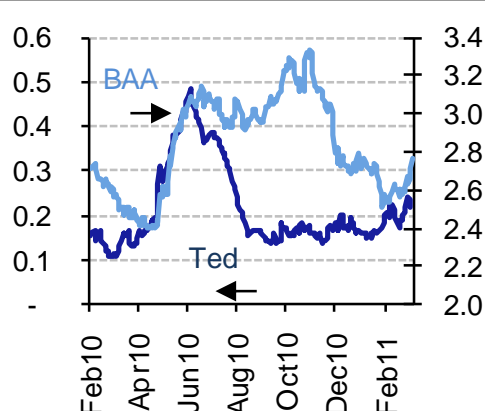
Source: Bloomberg & BBVA Research

Graph 7
Commercial Paper Issuance (US\$Bn)



Source: Bloomberg & BBVA Research

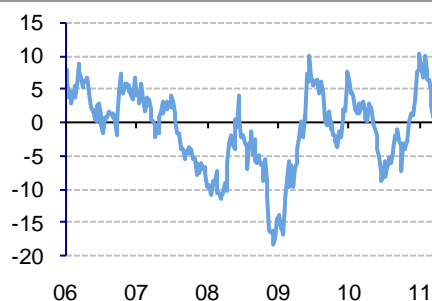
Graph 8
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

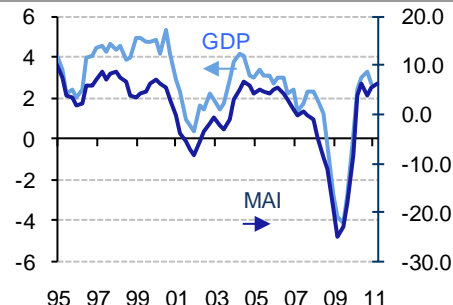
Economic Trends

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)**



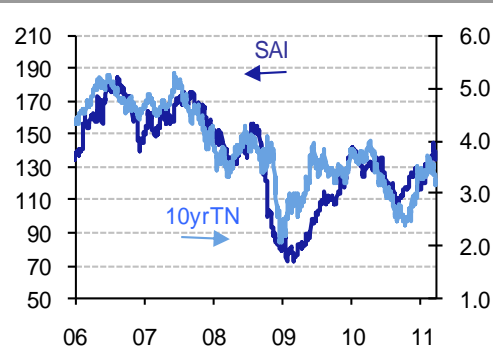
Source: BBVA Research & BEA

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



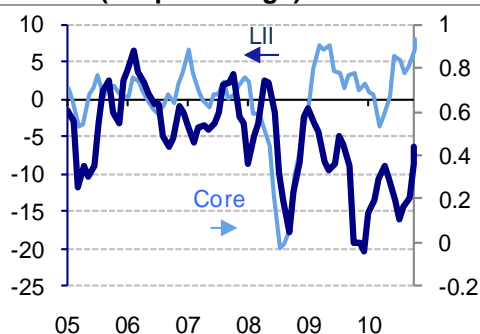
Source: BBVA Research

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



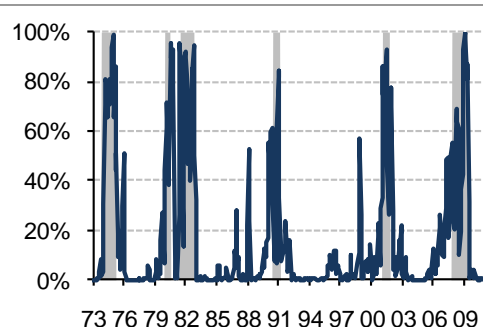
Source: Bloomberg & BBVA Research

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

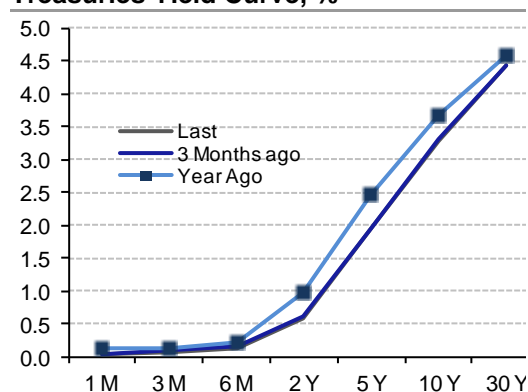
Key Interest Rates, %

| | 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 | 13.73 | 12.99 |
| New Auto (36-months) | 4.81 | 4.80 | 5.06 | 6.41 |
| Heloc Loan 30K | 5.47 | 5.48 | 5.55 | 5.71 |
| 30-year Fixed Mortgage * | 4.76 | 4.88 | 5.00 | 4.96 |
| Money Market | 0.61 | 0.61 | 0.63 | 0.82 |
| 2-year CD | 1.28 | 1.28 | 1.29 | 1.65 |
| 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

Paul Krugman
March 16, 2011
Yes, We're in a Liquidity Trap
New York Times Blog

"Short rates have stayed near zero; long rates have fluctuated with changing views about the prospects for recovery, but stayed consistently below historical norms. That's exactly what those of us who understood liquidity-trap economics predicted, right from the beginning."

Economic Calendar

| Date | Event | Period | Forecast | Survey | Previous |
|--------|---|--------|----------|--------|----------|
| 21-Mar | Chicago Fed Nat Activity Index | FEB | 0.1 | - - | -0.2 |
| 21-Mar | Existing Home Sales | FEB | 5.15M | 5.11M | 5.36M |
| 21-Mar | Existing Home Sales MoM | FEB | -3.9% | -4.7% | 2.7% |
| 22-Mar | House Price Index MoM | JAN | -0.32% | -0.20% | -0.30% |
| 22-Mar | Richmond Fed Manufact. Index | MAR | 20.0 | 23.0 | 25.0 |
| 23-Mar | New Home Sales | FEB | 297K | 290K | 284K |
| 23-Mar | New Home Sales MoM | FEB | 4.6% | 2.1% | -12.6% |
| 24-Mar | Durable Goods Orders | FEB | 0.5% | 1.0% | 3.2% |
| 24-Mar | Durables Ex Transportation | FEB | 1.4% | 2.0% | -3.0% |
| 24-Mar | Initial Jobless Claims | 19-Mar | 375K | 383K | 385K |
| 24-Mar | Continuing Claims | 12-Mar | 3680K | 3693K | 3706K |
| 25-Mar | GDP QoQ (Annualized) | 4Q T | 2.9% | 3.0% | 2.8% |
| 25-Mar | GDP Price Index | 4Q T | 0.4% | 0.4% | 0.4% |
| 25-Mar | Core PCE QoQ | 4Q T | 0.5% | 0.5% | 0.5% |
| 25-Mar | Personal Consumption | 4Q T | 4.1% | 4.1% | 4.1% |
| 25-Mar | U. of Michigan Confidence | MAR F | 68.0 | 68.0 | 68.2 |
| 25-Mar | Annual Revisions: Industrial Production | | --- | --- | --- |

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