

# Weekly Watch

U.S.

## Highlights

May 23<sup>rd</sup>, 2011  
Economic Analysis

U.S.

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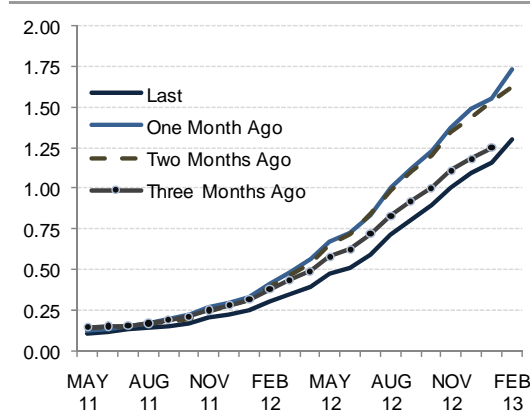
### The Fed Remains in No Rush to Raise Interest Rates

The minutes from the April 26-7 Federal Open Market Committee (FOMC) indicates that members extensively discussed different strategies for reversing extraordinary monetary policy arising from the 2008 crisis. FOMC members agree on some broad principles to guide their decision-making regarding normalization. They believe that the eventual goal is a reduction of the System Open Market Account (SOMA) to a point where the Fed Funds rate becomes again the primary active policy instrument. Eventually the SOMA will hold only Treasury securities, implying sales of agency securities at some point. The FOMC believes that asset sales should be communicated to the public in advance and possibly tied to economic conditions. Nearly all participants agreed that a first step in normalization would be the cessation of reinvestment of principal from maturing SOMA securities. Overall, the Fed remains in no rush to raise interest rates as a result of excess resource slack, although it is increasingly focused on the evolution of measures of inflation expectations. Due to uncertainty over the sustainability of the recovery, the timing of policy actions (balance sheet normalization, in particular), will depend on the evolution of data over the summer. We continue to expect a first rate hike in March 2012. For more detail see our latest [Fed Watch](#).

### Industrial Production Was Unchanged in April

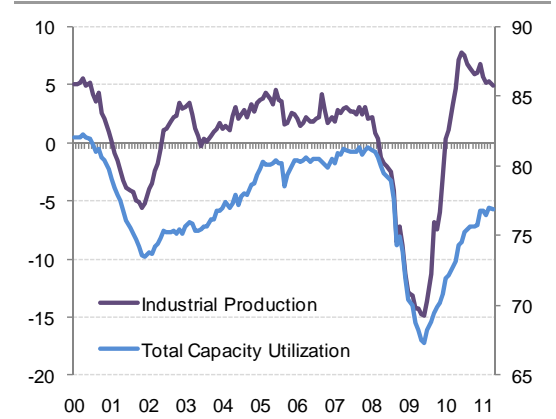
The Federal Reserve announced that the industrial production index (IPI) was unchanged in April after increasing 0.7% MoM in the previous month. The index, on average, increased by 0.2% MoM in 1Q11 consistent with weak 1Q11 real GDP growth. The slowdown was partially due to supply disruptions created by the earthquake in Japan. In April, manufacturing activity decreased by 0.4% and the capacity utilization in the sector declined to 74.4%, significantly lower than its historical average of 79.0% between 1972 and 2010. On the other hand, mining and utilities sectors expanded by 0.8% and 1.7% MoM, respectively. The total capacity utilization rate also declined slightly to 76.9% from 77.0%. The low capacity utilization level indicates large economic slack that remains in the economy and supports our expectations that inflationary pressures from production side will remain limited.

Graph 1  
Fed Funds Futures Contracts (%)



Source: Bloomberg and BBVA Research

Graph 2  
Capacity of Utilization and IPI (% & YoY % change)



Source: Federal Reserve

## Week Ahead

### New Home Sales (April, Tuesday 10:00 ET)

|                |                 |                |
|----------------|-----------------|----------------|
| Forecast: 295K | Consensus: 300K | Previous: 300K |
|----------------|-----------------|----------------|

New home sales are expected to continue to display weakness as demand is focusing mainly on the existing homes market and mortgage credit standards remain tight. As a result, new home sales will slightly decline in April to 295K from 300K. Since the end of the tax credit incentives in the first half of 2010, new home sales have averaged around 300K units (annualized), far below the forty-year average of 500K units sold per year. As a consequence of this fragile market for new homes, the homebuilders' confidence index are at historically low levels, suggesting that it could take some time for a full recovery of new homes building.

### Durable Goods Orders (April, Wednesday 08:30 ET)

|                 |                  |                |
|-----------------|------------------|----------------|
| Forecast: -2.1% | Consensus: -2.5% | Previous: 4.1% |
|-----------------|------------------|----------------|

The latest release indicates that new orders for manufactured durable goods in March increased by almost \$8bn or 4.1% MoM on a seasonally-adjusted basis, revised from the previously published 2.9% MoM increase after declining -1.1% MoM in the previous month. Transportation equipment also increased by 9.7% MoM in March. We expect durable goods orders to decline due to a big jump in March.

### Gross Domestic Product (1Q11 Second Estimate, Thursday 08:30 ET)

|                |                 |                |
|----------------|-----------------|----------------|
| Forecast: 2.2% | Consensus: 2.2% | Previous: 1.8% |
|----------------|-----------------|----------------|

The Bureau of Economic Analysis (BEA) estimated that the US economy grew 1.8% (QoQ, annualized) in 1Q11 on a seasonally adjusted basis compared to 3.1% in the previous quarter. The estimate indicates that personal consumption expenditures (PCE), private inventory investment, nonresidential fixed investment positively contributed to growth, while government spending, residential investment and net exports dragged down the economic recovery in 1Q11. Recent macroeconomic data indicate that the BEA will revise up its 1Q11 economic growth estimate from 1.8% to 2.2% most likely due to better than expected construction spending and private inventories.

### Personal Income and Outlays (April, Friday 08:30 ET)

|                      |                       |                      |
|----------------------|-----------------------|----------------------|
| Forecast: 0.5%, 0.5% | Consensus: 0.4%, 0.5% | Previous: 0.5%, 0.6% |
|----------------------|-----------------------|----------------------|

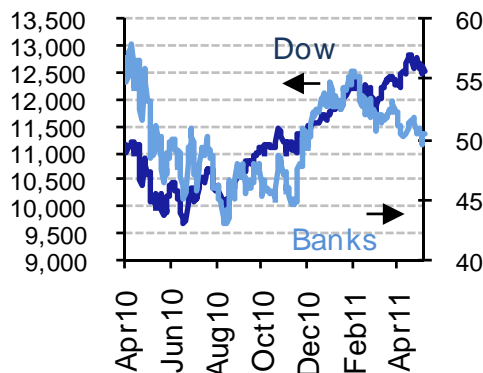
In March, personal income and spending increased by 0.5% and 0.6% MoM, respectively. However, most of the increase was due to an increase in prices rather than real activity. After removing price changes, personal spending increased moderately by 0.2%, compared with an increase of 0.5% in the previous month. We expect that personal income and spending will continue to rise in April similar to the previous month. However, the increase will remain low in real terms.

### Market Impact

This week, several macroeconomic releases will give more insight about 2Q11 economic growth. A significant increase in durable goods orders, personal spending and new home sales in April would signal robust growth in the current quarter and push equity prices higher.

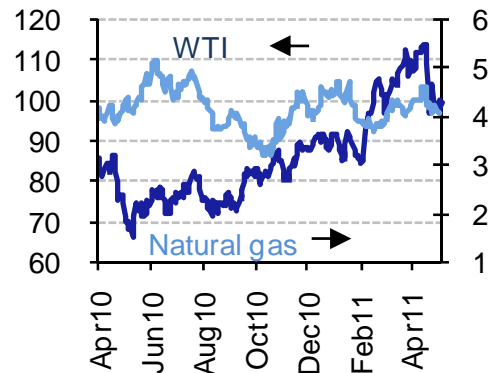
## Financial Markets

Graph 3  
Stocks (Index, KBW)



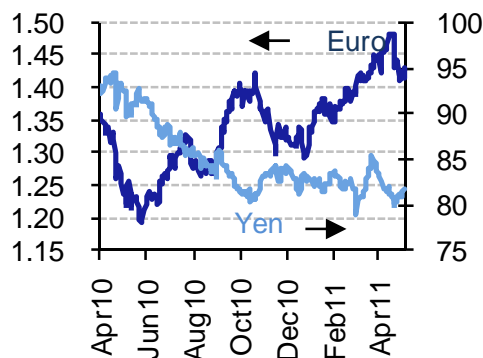
Source: Bloomberg & BBVA Research

Graph 4  
Commodities (Dpb & DpMMBtu)



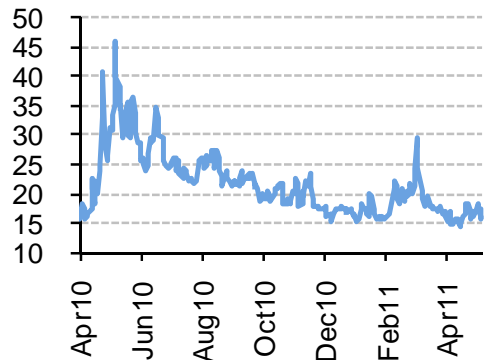
Source: Bloomberg & BBVA Research

Graph 5  
Currencies (Dpe & Ypd)



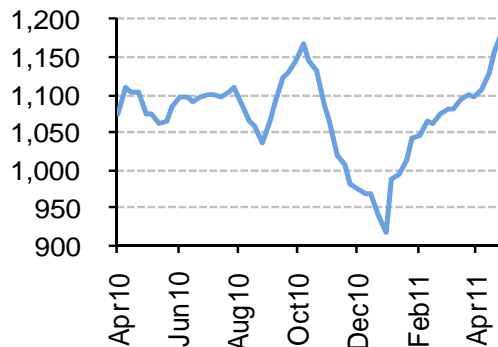
Source: Bloomberg & BBVA Research

Graph 6  
Volatility (Vix, Index)



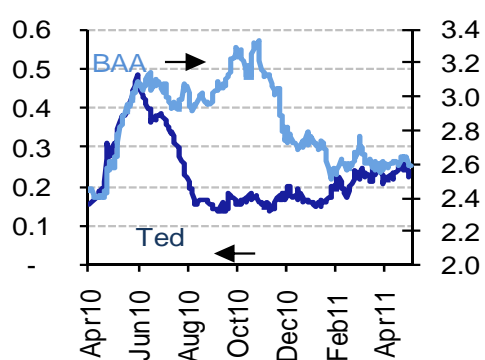
Source: Bloomberg & BBVA Research

Graph 7  
Commercial Paper Issuance (US\$Bn)



Source: Bloomberg & BBVA Research

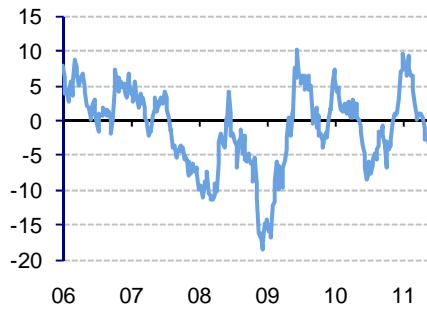
Graph 8  
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

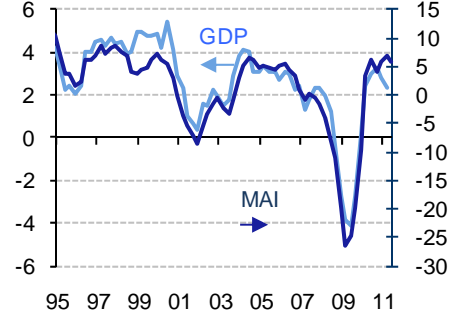
## Economic Trends

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)



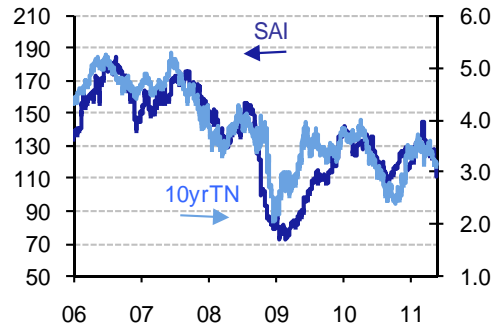
Source: BBVA Research & BEA

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



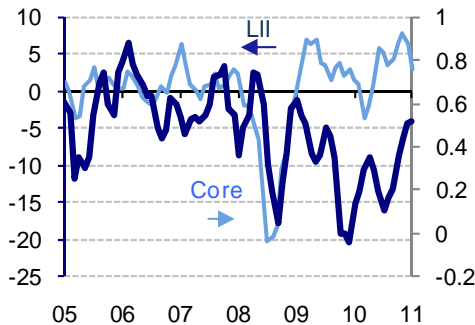
Source: BBVA Research

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



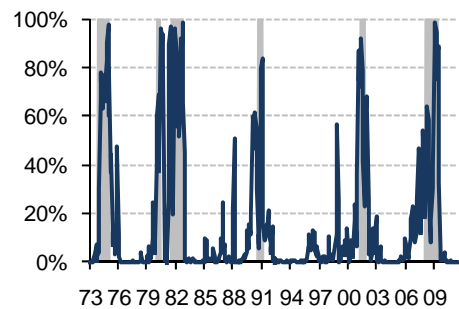
Source: Bloomberg & BBVA Research

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

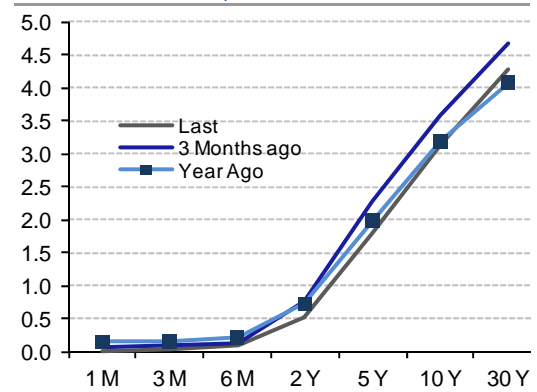
## Yield Curve and Interest Rates

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       | 13.00    |
| New Auto (36-months)     | 3.83  | 3.79     | 4.17        | 6.27     |
| Heloc Loan 30K           | 5.48  | 5.48     | 5.47        | 5.55     |
| 30-year Fixed Mortgage * | 4.61  | 4.63     | 4.80        | 4.84     |
| Money Market             | 0.63  | 0.62     | 0.65        | 0.78     |
| 2-year CD                | 1.23  | 1.23     | 1.25        | 1.67     |
| 5-year CD                | 2.07  | 2.07     | 2.09        | 2.62     |

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

Graph 15  
Treasury Yield Curve, %



Source: Bloomberg

## Quote of the Week

Federal Reserve Bank of Chicago President Charles Evans  
"Making Sense of Monetary Policy"  
May 19, 2011

AFP Global Corporate Treasurers Forum in Chicago, IL

*"Slow progress in closing resource gaps and a medium-term outlook for inflation that is too low lead me to conclude that substantial policy accommodation continues to be appropriate. This accommodative policy will foster a return of economic conditions consistent with our dual mandate."*

## Economic Calendar

| Date   | Event                          | Period | Forecast | Survey | Previous |
|--------|--------------------------------|--------|----------|--------|----------|
| 24-May | New Home Sales                 | APR    | 295K     | 300K   | 300K     |
| 24-May | Richmond Fed Manufact. Index   | MAY    | 10.50    | 9.00   | 10.00    |
| 25-May | Durable Goods Orders           | APR    | -2.1%    | -2.5%  | 4.1%     |
| 25-May | Durables Ex Transportation     | APR    | 0.0%     | 0.5%   | 2.3%     |
| 25-May | House Price Index MoM          | MAR    | -1.5%    | -0.5%  | -1.6%    |
| 25-May | House Price Purchase Index QoQ | 1Q     | -1.2%    | -1.0%  | -0.8%    |
| 26-May | GDP QoQ (Annualized)           | 1Q S   | 2.2%     | 2.2%   | 1.8%     |
| 26-May | Personal Consumption           | 1Q S   | 2.8%     | 2.8%   | 2.7%     |
| 26-May | GDP Price Index                | 1Q S   | 1.9%     | 1.9%   | 1.9%     |
| 26-May | Initial Jobless Claims         | 21-May | 405K     | 400K   | 409K     |
| 26-May | Continuing Claims              | 14-May | 3705K    | 3700K  | 3711K    |
| 27-May | Personal Income                | APR    | 0.5%     | 0.4%   | 0.5%     |
| 27-May | Personal Spending              | APR    | 0.5%     | 0.5%   | 0.6%     |
| 27-May | PCE Deflator (YoY)             | APR    | 2.1%     | 2.2%   | 1.8%     |
| 27-May | PCE Core (MoM)                 | APR    | 0.2%     | 0.2%   | 0.1%     |
| 27-May | U. of Michigan Confidence      | MAY F  | 71.40    | 72.40  | 72.40    |
| 27-May | Pending Home Sales MoM         | APR    | -2.5%    | -1.0%  | 5.1%     |

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