

# Weekly Watch

U.S.

## Highlights

20 June 2011  
Economic Analysis

U.S.

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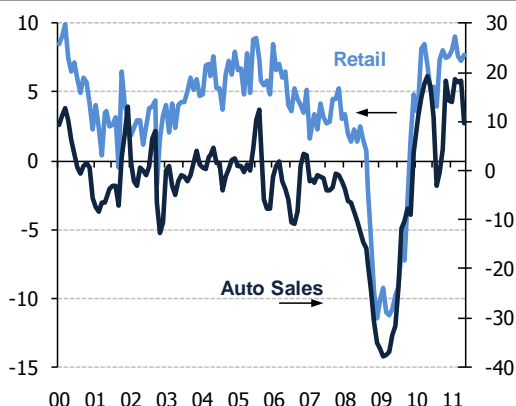
### Markets Remain Volatile Amidst Conflicting Economic Reports

The latest macroeconomic releases such as retail sales, industrial production, and the Fed's Beige Book suggest a slowdown in economic activity in 2Q11. However, the probability of a double-dip recession remains low. Tuesday's retail sales report illustrated that deceleration in May sales was due to a decline in auto sales. For the first time since June 2010, retail sales declined 0.2% MoM after increasing 0.3% in the previous month. However, retail sales excluding autos continued positive MoM growth of 0.3%. The numbers are modest in comparison to the robust numbers of April, but YoY growth for retail sales and retail sales excluding autos remains strong, increasing 7.7% and 8.2%, respectively. The decline in automotive sales is directly related to supply issues stemming from the Japanese earthquake and these supply issues are likely to persist through the next month, ultimately dragging down June sales. In addition, retail gasoline sales increased by 0.3% MoM and food and beverage sales are down 0.5% MoM.

Heading into Wednesday's CPI release, much of the markets concern centered on accelerating energy commodities and gasoline prices. However, for the first time in eleven months the energy index declined 1.0% MoM. Despite the May decline, the energy index still increased 21.5% YoY. The gasoline price index decreased 2.0% MoM, the largest decline since June 2010, while energy commodities declined 1.9% MoM. Contrary to headline inflation, core inflation rose to levels not seen since July 2008. The core consumer price index rose 0.3% MoM in May on a seasonally-adjusted basis. The leaders were apparel, shelter, new vehicles, and recreation, which increased 1.2%, 0.2%, 1.1% and 0.3% MoM, respectively. The food index also rose 0.4% MoM in May.

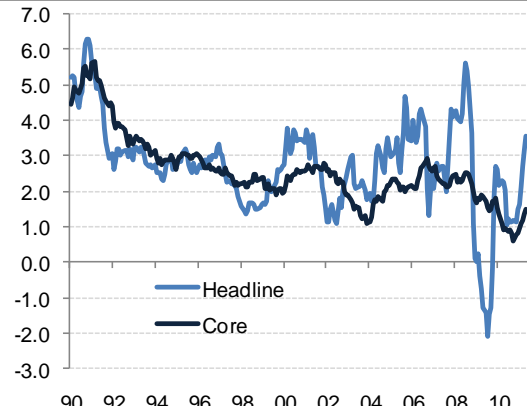
This week's announcements did little to solidify the market expectations as we approach the end of QE2. Conflicting economic indicators caused uncertainty about the strength and sustainability of the economic recovery and increased volatility in the financial markets. While moderate consumer demand, an increase in housing starts, and declining jobless claim all indicate increased economic activity: low capacity utilization, slow industrial production and significant manufacturing slack eliminated most of the optimism. In conclusion, current macroeconomic trends suggest that downside risks to our baseline scenario, which assumes 3% growth in 2011, increased significantly.

Graph 1  
Retail and Auto Sales (YoY % change)



Source: US Census Bureau

Graph 2  
Consumer Price Index (YoY % change)



Source: Bureau of Labor Statistics

## Week Ahead

### Existing Home Sales (May, Tuesday 10 ET)

|                |                 |                |
|----------------|-----------------|----------------|
| Forecast: 4.9M | Consensus: 4.8M | Previous: 5.0M |
|----------------|-----------------|----------------|

Next week the National Associations of Realtors will release existing home sales data for May. The wide dispersion of consensus estimates, ranging from an 8.9% MoM decline to a 2.4% MoM gain, embody the uncertainty surrounding the real estate market. Ample supply of price-reduced or distressed properties should positively impact existing home sales. Nevertheless, low consumer expectations, weak labor markets, and downside price risk are pushing housing demand away from ownership to a more defensive rental position. Therefore, we expect existing home sales to decline on a seasonally-adjusted basis in May.

### FOMC Rate Decision (May, Wednesday 12:30 ET)

|                      |                       |                      |
|----------------------|-----------------------|----------------------|
| Forecast: 0.0%-0.25% | Consensus: 0.0%-0.25% | Previous: 0.0%-0.25% |
|----------------------|-----------------------|----------------------|

A decelerating economy and rising prices might create a policy dilemma if sustained for long periods. However, the Fed believes that the recent increase in inflation is temporary and the pass-through effect to underlying prices will be limited. The latest CPI release showed that headline inflation rose 0.2% MoM in May, the lowest level of 2011, while core inflation was unexpectedly high at 0.3% MoM. We expect that the Fed will continue to monitor core inflation in 2H11. Moreover, after the recent slowdown, the Fed is more concerned with economic sustainability rather than inflation. Therefore, we expect no change to the current Fed Funds rate of 0% - 0.25%.

### Durable Goods Orders (May, Friday 8:30 ET)

|                |                 |                 |
|----------------|-----------------|-----------------|
| Forecast: 1.1% | Consensus: 1.6% | Previous: -3.6% |
|----------------|-----------------|-----------------|

Durable goods orders declined in April 3.6% MoM, on a seasonally adjusted basis, after a large jump in March (4.6% MoM). Most of the industries saw declines in new orders but the main driver of this drop was transportation equipment, which had the largest decrease in the last four months by 9.3%. We expect economic activity to increase in 2Q11, which should positively impact durable goods orders in May.

### Gross Domestic Product, Final (1Q11, Friday 8:30 ET)

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

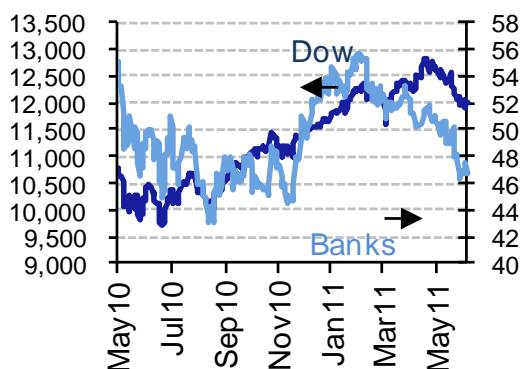
Last month, the Bureau of Economic Analysis (BEA) revised exports, private inventory and nonresidential fixed investment upward, which were offset by upward revisions to imports and a downward revision to personal consumption expenditures. We expect no major revision to GDP and the GDP Deflator in the final estimate, keeping the 1Q11 GDP growth estimate at 1.8% on a QoQ annualized rate. However, the BEA will release its annual revision of the national income and product accounts next month along with revisions to GDP and its components since 1Q03. This revision might change annual growth estimates since 2003.

### Market Impact

Financial markets will be focused on the Federal Open Market Committee's scheduled meeting. We expect markets to experience only small adjustments following the Fed's announcement on Wednesday. However, if there are significant changes in the statement signaling any policy change, equity and fixed income markets will respond accordingly.

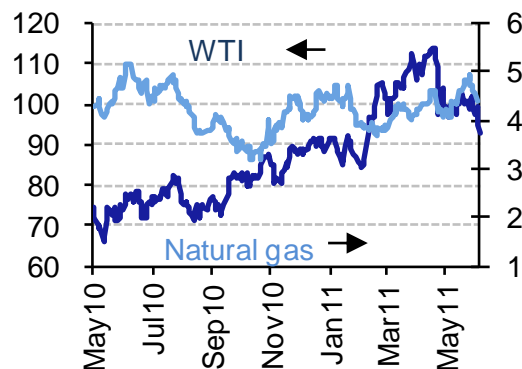
## Financial Markets

Graph 3  
Stocks (Index, KBW)



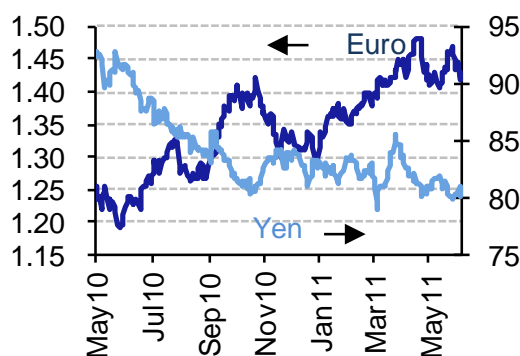
Source: Bloomberg & BBVA Research

Graph 4  
Commodities (Dpb & DpMMBtu)



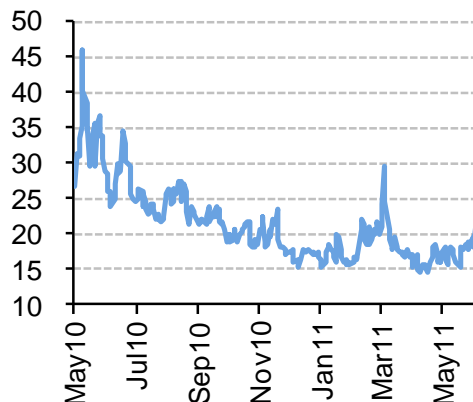
Source: Bloomberg & BBVA Research

Graph 5  
Currencies (Dpe & Ypd)



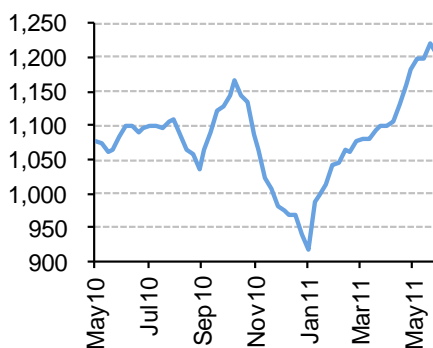
Source: Bloomberg & BBVA Research

Graph 6  
Volatility (Vix, Index)



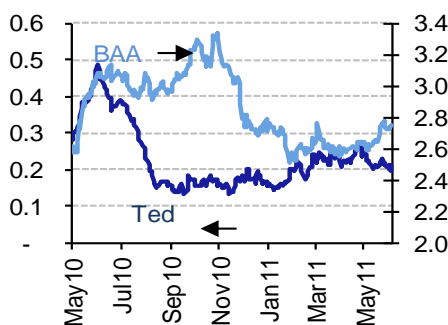
Source: Bloomberg & BBVA Research

Graph 7  
Commercial Paper Issuance (US\$Bn)



Source: Bloomberg & BBVA Research

Graph 8  
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

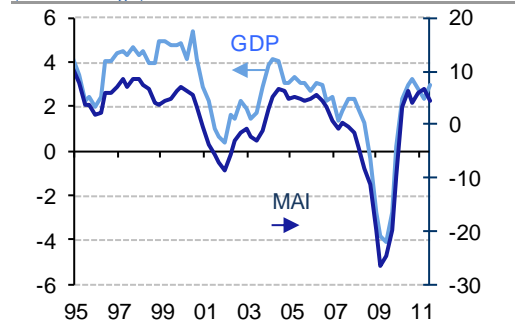
## Economic Trends

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)



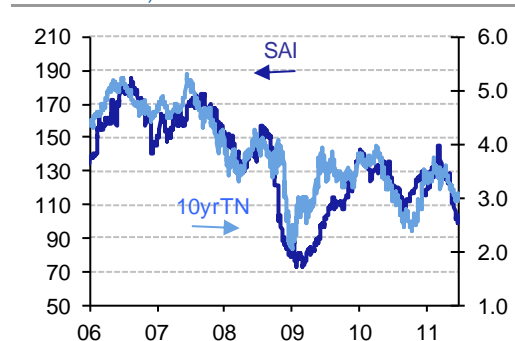
Source: BBVA Research & BEA

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



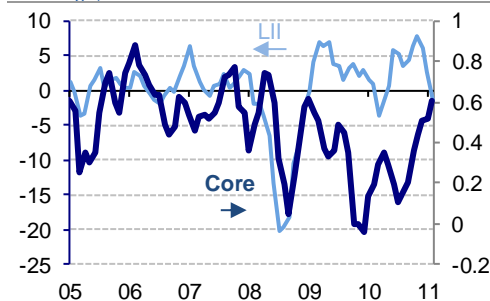
Source: BBVA Research

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



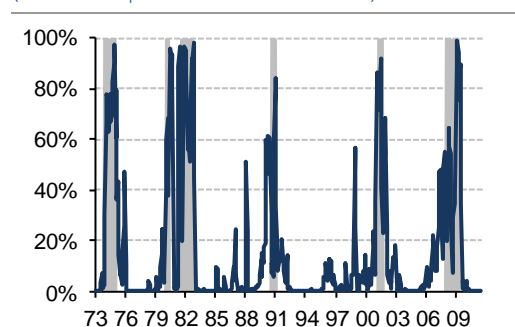
Source: Bloomberg & BBVA Research

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

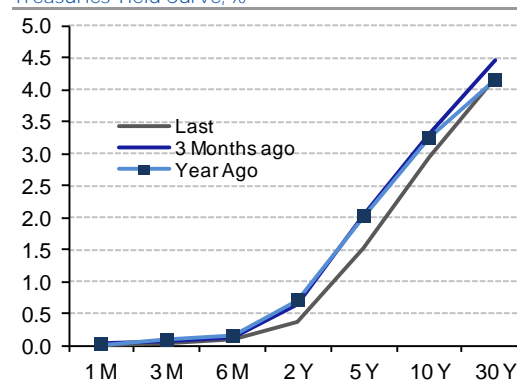
## Yield Curve and Interest Rates

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       | 13.44    |
| New Auto (36-months)     | 3.71  | 3.70     | 3.83        | 6.28     |
| Heloc Loan 30K           | 5.52  | 5.50     | 5.48        | 5.55     |
| 30-year Fixed Mortgage * | 4.50  | 4.49     | 4.61        | 4.75     |
| Money Market             | 0.62  | 0.63     | 0.63        | 0.78     |
| 2-year CD                | 1.08  | 1.11     | 1.23        | 1.57     |
| 5-year CD                | 2.05  | 2.05     | 2.07        | 2.56     |

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

Graph 15  
Treasury's Yield Curve, %



Source: Bloomberg

## Quote of the Week

Federal Reserve Board of Governor Daniel K. Tarullo  
"Capital and Liquidity Standards"  
16 June 2011 Washington, D.C.

*"An international process for monitoring implementation on a bank-by-bank basis has become increasingly necessary as capital standards have relied to a greater extent on internal market-risk or credit-risk models, the parameters and operation of which are not transparent"*

## Economic Calendar

| Date                           | Period | Forecast | Survey | Previous |
|--------------------------------|--------|----------|--------|----------|
| Existing Home Sales            | MAY    | 4.90M    | 4.80M  | 5.05M    |
| Existing Home Sales MoM        | MAY    | -3.0%    | -5.00% | -0.80%   |
| House Price Index MoM          | APR    | -0.3%    | -0.3%  | -0.3%    |
| FOMC Rate Decision             | 22-Jun | 0.25%    | 0.25%  | 0.25%    |
| Chicago Fed Nat Activity Index | MAY    | -0.040   | -0.030 | -0.450   |
| Initial Jobless Claims         | 17-Jun | 410K     | 412K   | 427K     |
| New Home Sales                 | MAY    | 315K     | 310K   | 323K     |
| New Home Sales MoM             | MAY    | -2.5%    | -4.0%  | 7.3%     |
| Durable Goods Orders           | MAY    | 1.1%     | 1.6%   | -3.6%    |
| Durables Ex Transportation     | MAY    | 0.9%     | 1.0%   | -1.5%    |
| GDP QoQ (Annualized)           | 1Q T   | 1.8%     | 1.9%   | 1.8%     |
| Personal Consumption           | 1Q T   | 2.2%     | 2.2%   | 2.2%     |
| GDP Price Index                | 1Q T   | 1.9%     | 1.9%   | 1.9%     |
| Core PCE QoQ                   | 1Q T   | 1.4%     | 1.4%   | 1.4%     |

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