

Weekly Watch

U.S.

4 July 2011
Economic Analysis

U.S.

Boyd Stacey
boyd.stacey@bbvacompass.com

Marcial Nava
marcial.nava@bbvacompass.com

Kim Fraser
kim.fraser@bbvacompass.com

Highlights

ISM Manufacturing index rebounds after May dip

The manufacturing sector bounced back in June from its May pullback, according to this week's ISM report. The ISM diffusion index was reported as 55, which is up 1.8pp from May. The rebound continues 23 consecutive months of manufacturing sector growth (index >50), and also indicates economic growth over the same period. Twelve of the eighteen reporting sectors indicated growth including, computer and electronic products, transportation equipment, machinery, and electrical equipment. However, there were reports of electronic components were in short supply. Sector employment is up 1.7pp since May. In sum, the rebound should partially soothe current market anxiety over a general slowdown in manufacturing, and could also moderate the increasing downside risk to 2Q11 GDP.

The Fed ends its second round of LSAP

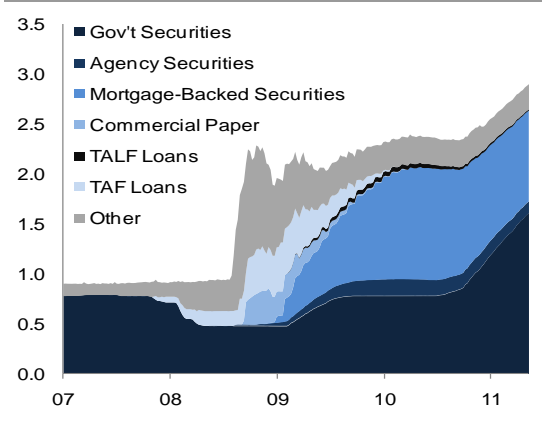
Thursday marked the end of the Fed's Large Scale Asset Purchases (LSAP) plan that targeted purchases of \$600bn in government securities. Since the announcement in November, the Fed balance sheet has undergone a significant facelift. At the close of LSAP, the Fed holds \$911bn in mortgage-backed securities (MBS), \$12.9bn in TALF loans, and \$118bn in agency securities. However, these crisis-related holdings have declined for 31 consecutive weeks (WoW) and the balance sheet has shifted to government securities, which increased \$759bn or 89% since 10 November. Recent statements by the Fed imply continued reinvestment of retiring principal. Previous Federal Reserve minutes also unveiled discussion of an eventual aim for an all-government securities balance sheet, a feat that the Fed is gradually achieving, although the absolute size of the balance sheet remains an obstacle. Excess reserves took a breather from their recent high growth rates of the past few months and declined by \$42bn.

Graph 1
ISM Manufacturing Index & New Orders Index



Source: ISM

Chart 2
Factors Absorbing Reserve Funds (\$tr)



Source: Federal Reserve

Week Ahead

ISM Non-Manufacturing Index (June, Wednesday 10:00 ET)

Forecast: 54.0	Consensus: 53.6	Previous: 54.6
----------------	-----------------	----------------

The ISM Non-Manufacturing composite index increased 1.8pp in May to 54.6. A composite index above 50 indicates that the service sector is expanding. Employment in the service sector continues to grow as suggested by the employment index, which increased from 51.9 to 54.0 in May. However, the general slowdown in economic activity will be offset by the seasonal spending, thus we expect the report to still show little change over last month.

Jobless Claims (June 24, Thursday 8:30 ET)

Forecast: 427k	Consensus: 420k	Previous: 428k
----------------	-----------------	----------------

The initial jobless claims report receded this week after a significant jump in the previous week. However, on a seasonally adjusted basis, the 4-week moving average remains effectively unchanged. Weak job conditions continue to weigh on the economy and with no data indicating otherwise, we expect claims to decline but only slightly. This week's report will precede the more meaningful employment survey report.

Consumer Credit (May, Friday 3:00 ET)

Forecast: \$5.2B	Consensus: \$4.3B	Previous: \$6.3B
------------------	-------------------	------------------

We expect seasonally-adjusted consumer credit to increase for the eighth consecutive month to \$2433.4bn, although at a slower pace than last month. Nonrevolving credit, such as auto and student loans, are also trending upwards increasing \$7.2bn MoM in April. However, revolving credit continues to decline, indicating that consumers are reluctant to take on more credit card debt. Looking forward, the lack of job market growth and rising commodity prices suggest that consumer spending is likely to remain sluggish in the coming months.

Nonfarm Payroll, Unemployment (June, Friday 8:30 ET)

Forecast: 65k, 9.1%	Consensus: 89k, 9.1%	Previous: 54k, 9.1%
---------------------	----------------------	---------------------

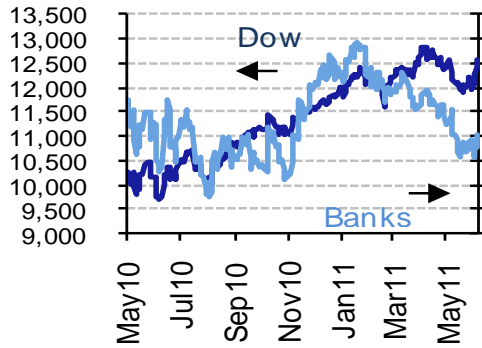
The previous month's employment report indicated non-farm payroll employment is decelerating. The nonfarm payroll increased by 54k jobs, on a seasonally adjusted basis, but added 178k fewer jobs than in May. Furthermore, last month's report was below the previous three-month average of 220k. Continued fiscal cuts at the federal, state, and local levels are likely to negatively impact nonfarm payrolls in June. The number of initial jobless claims remains relatively constant, thus we expect nonfarm payrolls increase only modestly in June. Employment creation will increasingly capture the market if the employment data surprises to the downside.

Market Impact

A holiday shortened work week, in combination with limited economic releases, should foster a calm market environment. However, at week's end, we will have a better idea of the employment situation going in to the 2H11. If the employment situation deteriorates, we would expect investors to react negatively in anticipation of an economic slowdown.

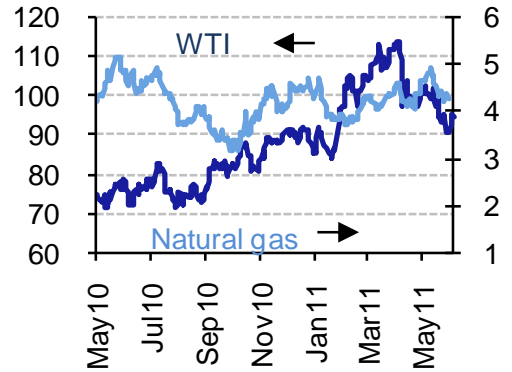
Financial Markets

Graph 3
Stocks (Index, KBW)



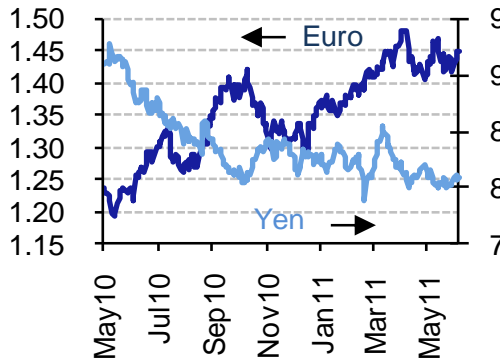
Source: Bloomberg & BBVA Research

Graph 4
Commodities (Dpb & DpMMBtu)



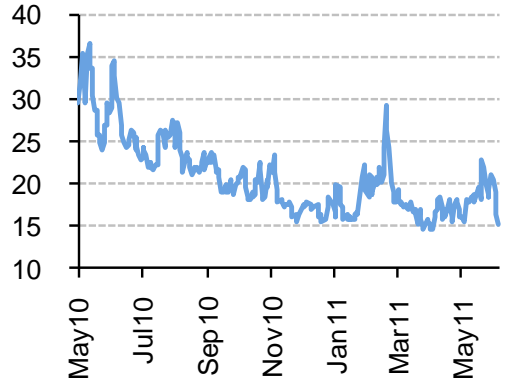
Source: Bloomberg & BBVA Research

Graph 5
Currencies (Dpe & Ypd)



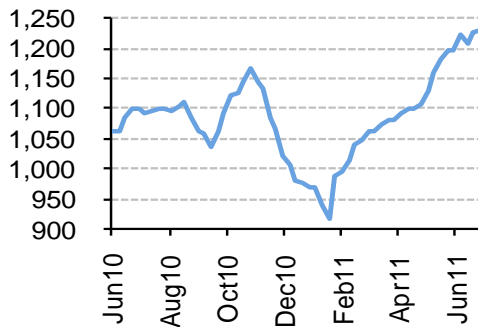
Source: Bloomberg & BBVA Research

Graph 6
Volatility (Vix, Index)



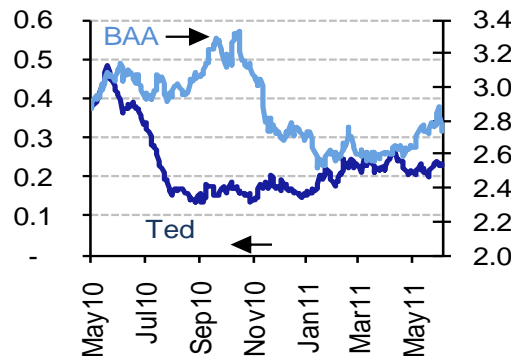
Source: Bloomberg & BBVA Research

Graph 7
Commercial Paper Issuance (US\$Bn)



Source: Bloomberg & BBVA Research

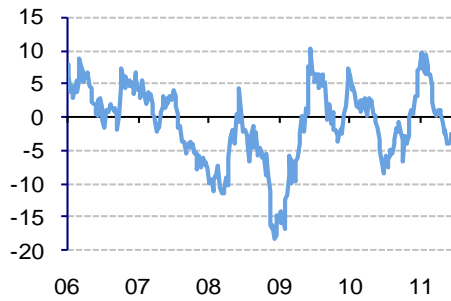
Graph 8
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

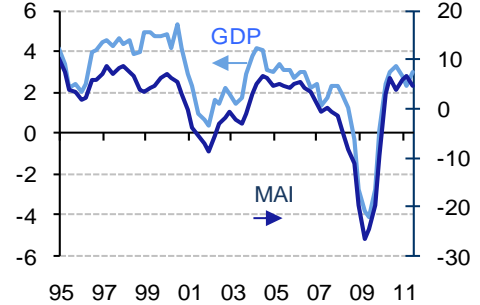
Economic Trends

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)



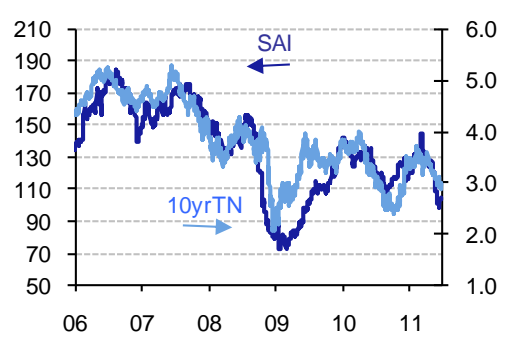
Source: BBVA Research & BEA

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



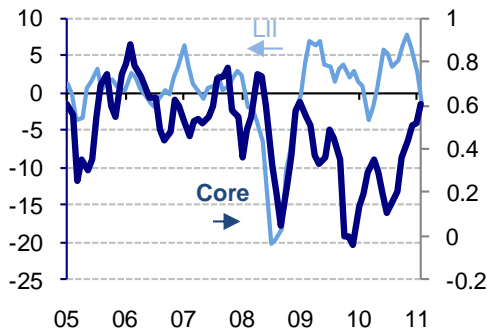
Source: BBVA Research

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



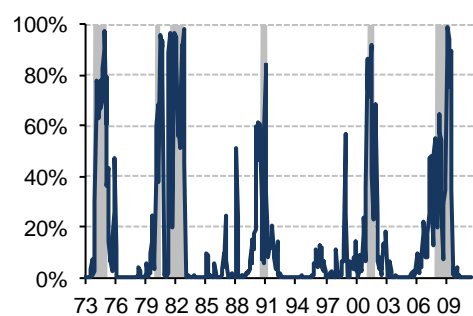
Source: Bloomberg & BBVA Research

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

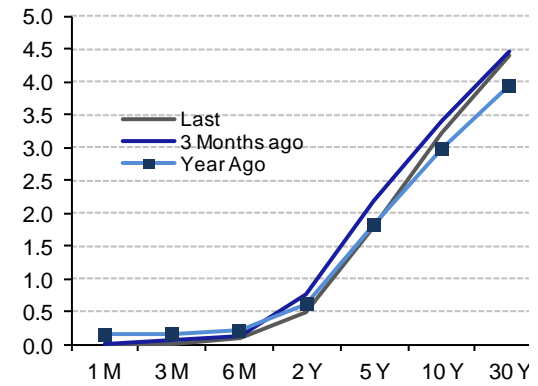
Yield Curve and Interest Rates

Table 1
Key Interest Rates, %

Key Interest Rates	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)	3.66	3.91	3.80	6.33
Heloc Loan 30K	5.53	5.52	5.49	5.58
30-year Fixed Mortgage *	4.51	4.50	4.55	4.58
Money Market	0.62	0.62	0.62	0.78
2-year CD	1.05	1.05	1.12	1.55
5-year CD	2.05	2.05	2.12	2.53

* 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

President of the Kansas City Federal Reserve Thomas Hoenig
The Rotary Club of Des Moines and the Greater Des Moines Partnership
June 30, 2011

"I am concerned that in working to offset the effects of this devastating crisis and to restore the economy to health, an extended zero-interest-rate policy is producing new sources of fragility that we need to be aware of and allow for in our future policy choices."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
5-Jul	Factory Orders	MAY	-1.2%	1.0%	-1.2%
6-Jul	ISM Non-Manf. Composite	JUN	54.0	53.6	54.6
7-Jul	ADP Employment Change	JUN	50K	80K	38K
7-Jul	Initial Jobless Claims	2-Jul	427K	420K	428K
7-Jul	Continuing Claims	25-Jun	3702K	3700K	3702K
8-Jul	Change in Nonfarm Payrolls	JUN	65K	89K	54K
8-Jul	Change in Private Payrolls	JUN	81K	120K	83K
8-Jul	Unemployment Rate	JUN	9.1%	9.1%	9.1%
8-Jul	Avg Weekly Hours All Employees	JUN	34.4	34.4	34.4
8-Jul	Wholesale Inventories	MAY	0.7%	0.6%	0.8%
8-Jul	Consumer Credit	MAY	\$5.2B	\$3.7B	\$6.3B

Chief Economist for US

Nathaniel Karp
Nathaniel.karp@bbvacompass.com

Ignacio San Martin
Ignacio.SanMartin@bbvacompass.com

Jeffrey Owen Herzog
Jeff.Herzog@bbvacompass.com

Marcial Nava
Marcial.Nava@bbvacompass.com

Kim Fraser
Kim.Fraser@bbvacompass.com

Jason Frederick
Jason.Frederick@bbvacompass.com

Boyd Stacey
Boyd.Stacey@bbvacompass.com

Contact details

BBVA Research
5 Riverway Drive
Houston, Texas 77056

BBVA Research reports are available in English and Spanish

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document is based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates' salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") Of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".

BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.