

# Weekly Watch

U.S.

4 July 2011  
Economic Analysis

U.S.

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## 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

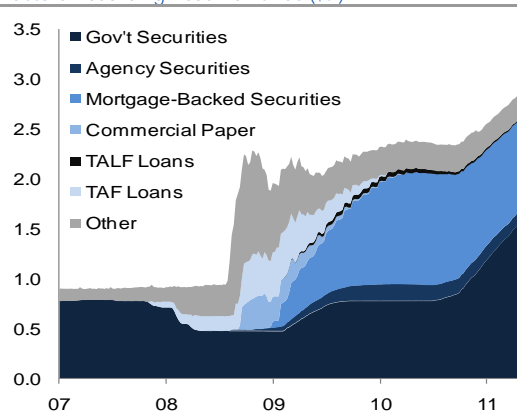
Thursday marked the end of the Fed's Large Scale Asset Purchases (LSAP) plan that targeted purchases of \$600bn in government securities. Since the announcement in November, the Fed balance sheet has undergone a significant facelift. At the close of LSAP, the Fed holds \$911bn in mortgage-backed securities (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
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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
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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
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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%
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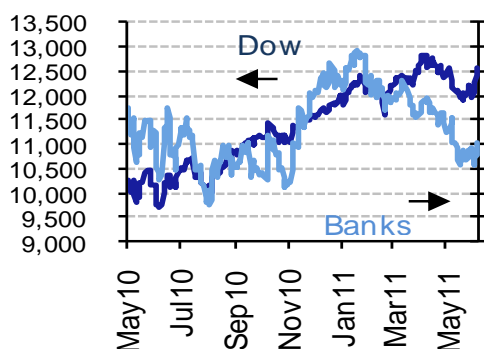
The previous month's employment report indicated non-farm payroll employment is decelerating. The nonfarm payroll increased by 54k jobs, on a seasonally adjusted basis, but added 178k fewer jobs than in May. Furthermore, last month's report was below the previous three-month average of 220k. Continued 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.

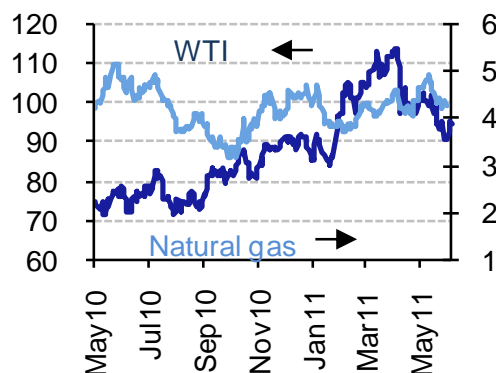
## Financial Markets

Graph 3  
Stocks (Index, KBW)



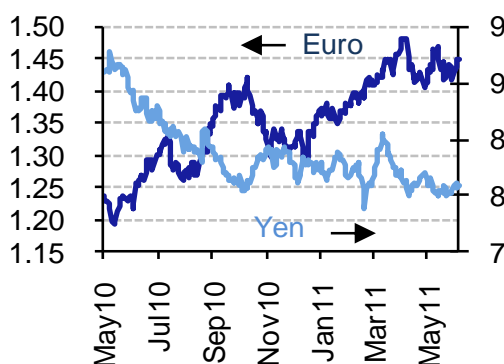
Source: Bloomberg & BBVA Research

Graph 4  
Commodities (Dpb & DpMMBtu)



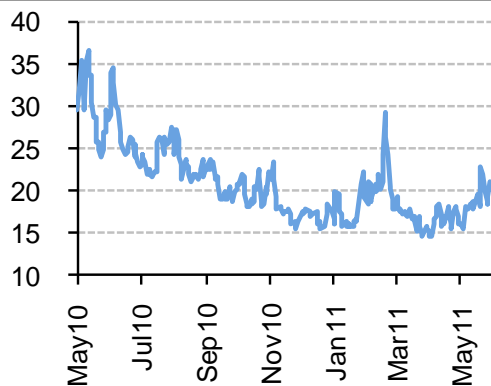
Source: Bloomberg & BBVA Research

Graph 5  
Currencies (Dpe & Ypd)



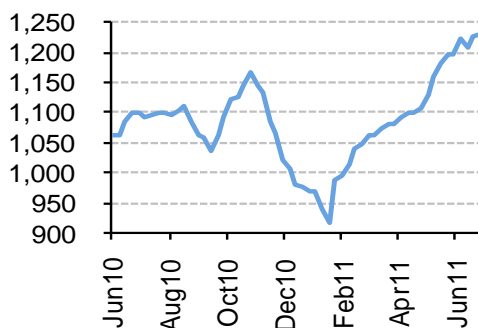
Source: Bloomberg & BBVA Research

Graph 6  
Volatility (Vix, Index)



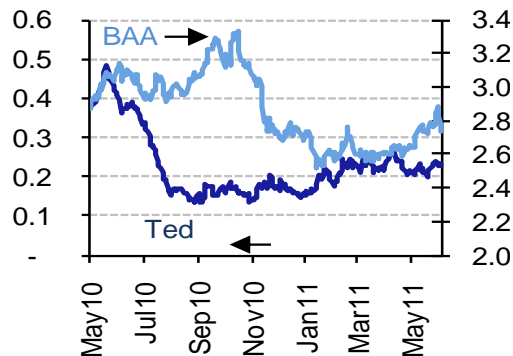
Source: Bloomberg & BBVA Research

Graph 7  
Commercial Paper Issuance (US\$Bn)



Source: Bloomberg & BBVA Research

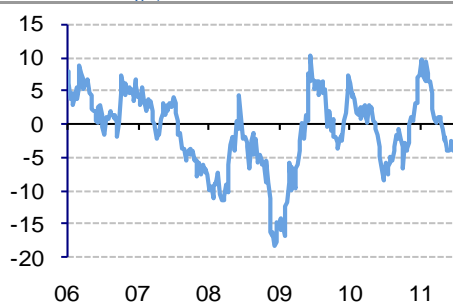
Graph 8  
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

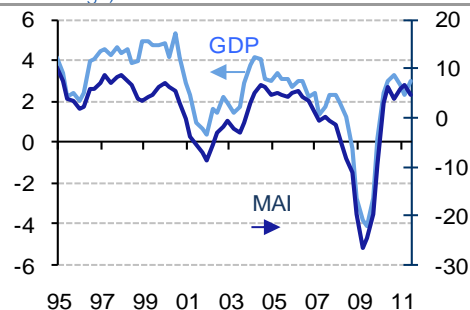
### Economic Trends

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)



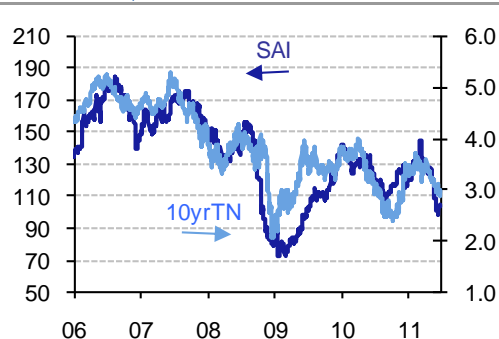
Source: BBVA Research & BEA

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



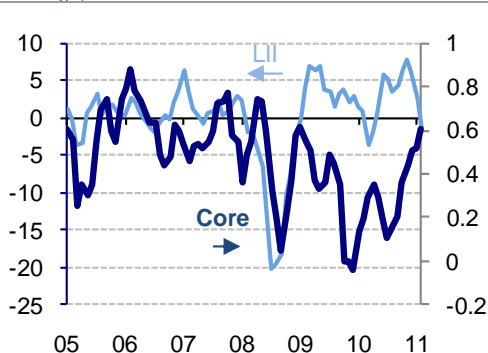
Source: BBVA Research

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



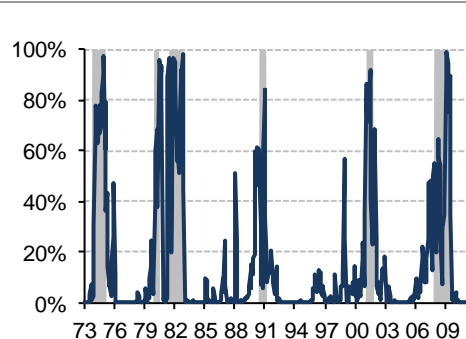
Source: Bloomberg & BBVA Research

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, %)



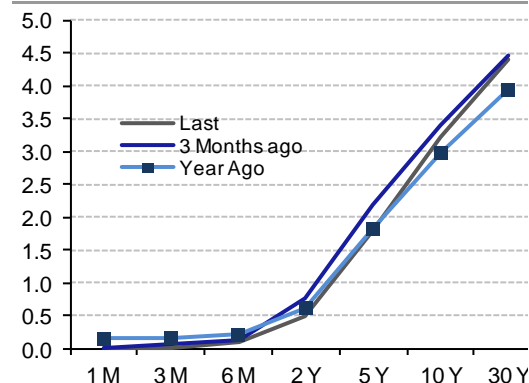
Source: BBVA Research

## Yield Curve and Interest Rates

 Table 1  
Key Interest Rates, %

Key Interest Rates	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

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