

Weekly Watch

U.S.

Highlights

11 July 2011
Economic Analysis

U.S.

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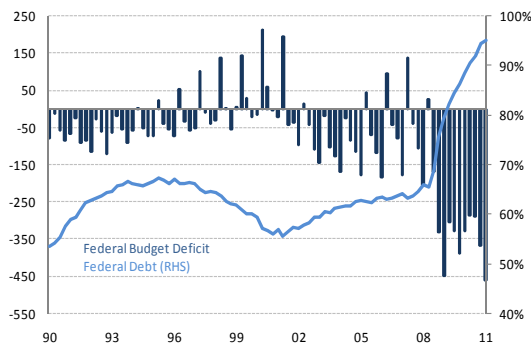
Past Due: Deadline to raise the debt ceiling is August 2nd, procedural deadline is July 22nd

The deadline to raise the debt ceiling is fast approaching, yet the political gridlock endures. Nevertheless, Congress must increase the debt ceiling if it intends to maintain its superlative credit rating. Not doing so would be catastrophic. The prospect of sovereign default, as seen through the lens of European contagion, has significant domestic consequences. First, if the debt ceiling is not increased the most immediate consequence is a downgrade of the current U.S. debt rating. The S&P has stated that it would reevaluate its current rating in mid-July. The July deadline incorporates the time needed to pass house procedural requirements. Official debt payments are due on August 4th, and a failure to pay, would be the first time the United States missed a payment. This would likely cause a precipitous drop to the lowest sovereign debt rating (D). The decrease would exponentially increase previous debt payments, and drive up costs for refinancing and traditional borrowing. Increasing the debt ceiling will temporarily bandage debt concerns, yet long-run sustainability will depend on protracted fiscal consolidation.

Nonfarm payrolls slide while unemployment climbs

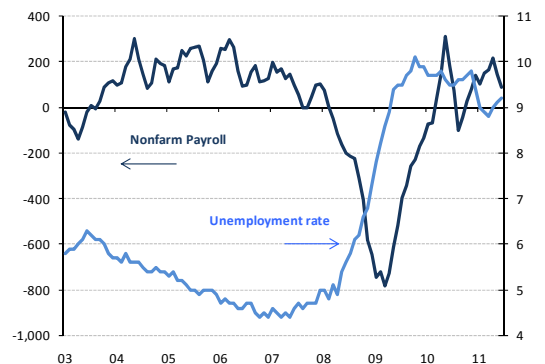
The BLS preliminary nonfarm payroll report for June indicated the country added only 18,000 jobs last month; consensus estimates ranged from 60-175k. The May nonfarm payroll report was also revised down to 25k from the preliminary estimate 54k, possibly indicating the employment situation is deteriorating more rapidly than consensus estimates. The weak job report surprised markets, because Thursday's ADP report stated that the private sector added 157k jobs in June. A near ubiquitous slide occurred in all sectors excluding manufacturing, healthcare services and social assistance, and retail trade. In addition the unemployment rate increased by 10bp to 9.2%, which is the highest of the year. It is too early to declare a downward trend in employment creation. The ISM surveys along with strong corporate profits suggest that economic expansion will continue in the 2H11, though the data does increase downside risks and supports our view that a rate hike will not occur before 1Q12.

Graph 1
Federal Budget Deficit and Debt to GDP Ratio (\$Bn & %)



Source: CBO & Treasury Department

Chart 2
Nonfarm Payroll and Unemployment rate (3MMA, K & %)



Source: BLS

Week Ahead

Trade Balance (May, Tuesday 8:30 ET)

Forecast: -43B	Consensus: -44B	Previous: -43.7B
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Declining auto imports helped close the trade gap in April, which declined from a revised 46.8M in March to 43.7M in April. Exports decelerated in April, but still increased 1.3% MoM. Also, a small MoM increase in imports aided in the decline of the trade deficit. Auto supply chains continue to be lacking, following the Japanese earthquakes, and will likely continue to put downward pressure on imports. Conversely rising oil prices will push-up imports. However, we do not expect the pressure on imports to significantly affect the trade gap in May, thus we expect the no change to the overall balance.

Retail Sales (June, Thursday 8:30 ET)

Forecast: 0.1%	Consensus: 0.0%	Previous: -0.2%
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Slack in the automotive industry weighed down retail sales, which declined 0.2% MoM in May. Auto sales remained weak due to inconsistent demand and rising prices, which ultimately pulled down the headline measure in May. However, price impacts are expected to dissipate as supply chains normalize throughout the summer, which should boost headline retail sales. However, we are not expecting significant increases in auto sales, and therefore expect only modest MoM retail sales growth.

Consumer Price Index, Core (June, Friday 8:30 ET)

Forecast: 0.0%, 0.2%	Consensus: -0.1%, 0.2%	Previous: 0.2%, 0.3%
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We expect CPI to remain unchanged in June as energy prices declined during the month. This decline will help to reduce the risk of pass-through to core inflation. In addition, strong corporate profits suggest that firms still have room to absorb shocks in energy prices, while substantial economic slack is containing wage and price pressures. As a result, we expect core prices to return to trend and expand 0.2% in June from 0.3% in May.

Industrial Production (June, Friday 9:15 ET)

Forecast: 0.2%	Consensus: 0.3%	Previous: 0.1%
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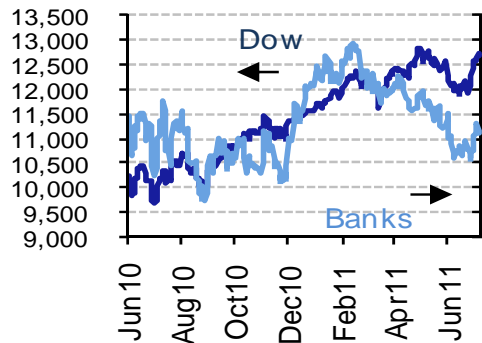
The industrial production index rose 0.1% MoM in May while the capacity utilization remained unchanged. The increase in industrial production came after zero growth in the previous period. Given that automotive supply chains are normalizing, thus increasing auto manufacturing, and the data from July ISM manufacturing index was positive, we expect industrial production increase in June.

Market Impact

This week's indicators should help in understanding current consumer and industrial demand. Strong retail sales could indicate consumption is unwavering in weak job conditions. In addition, Growing industrial production could strengthen the idea that the economic slowdown is temporary. If both retail sales and industrial production increase, and inflation remain consistent with the implied fed target, equity markets will respond favorably.

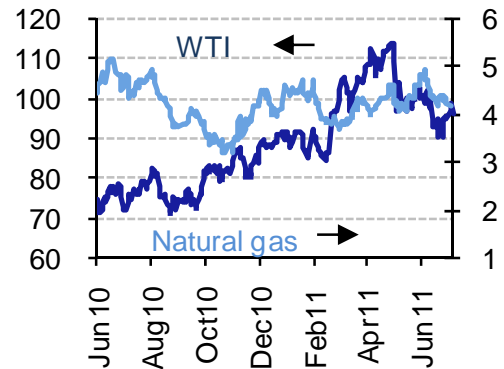
Financial Markets

Graph 3
Stocks (Index, KBW)



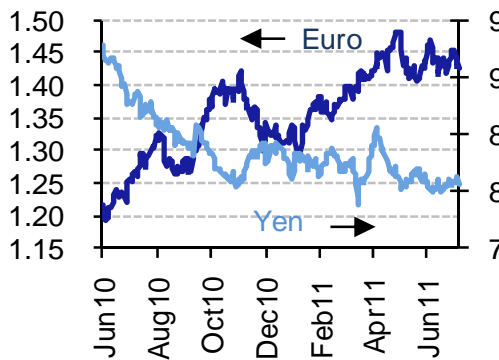
Source: Bloomberg & BBVA Research

Graph 4
Commodities (Dpb & DpMMBtu)



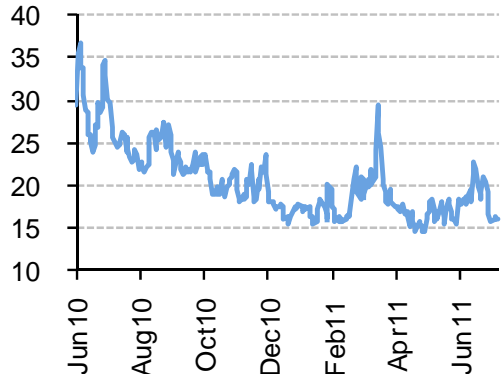
Source: Bloomberg & BBVA Research

Graph 5
Currencies (Dpe & Ypd)



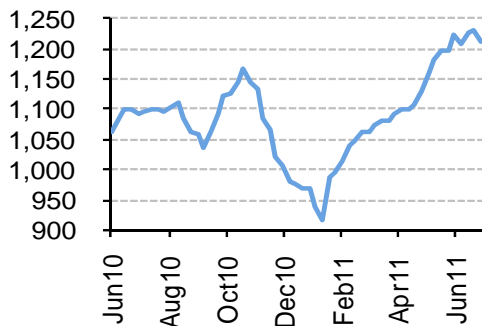
Source: Bloomberg & BBVA Research

Graph 6
Volatility (Vix, Index)



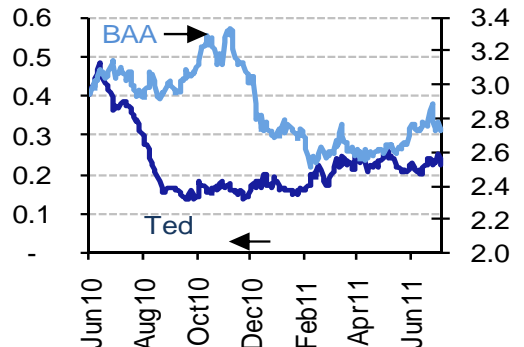
Source: Bloomberg & BBVA Research

Graph 7
Commercial Paper Issuance (US\$Bn)



Source: Bloomberg & BBVA Research

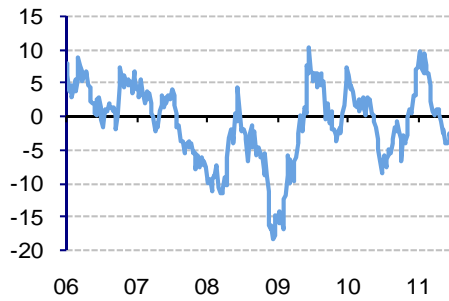
Graph 8
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

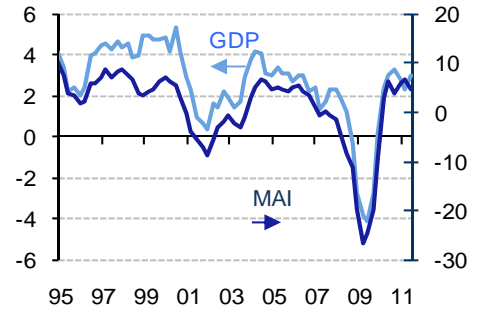
Economic Trends

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)



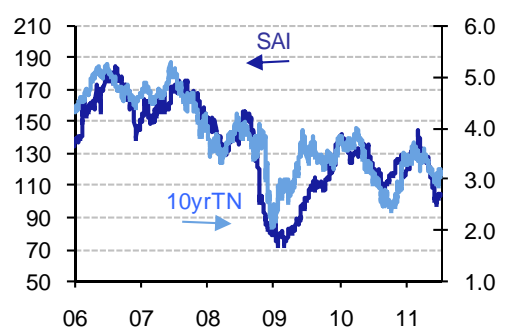
Source: BBVA Research & BEA

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



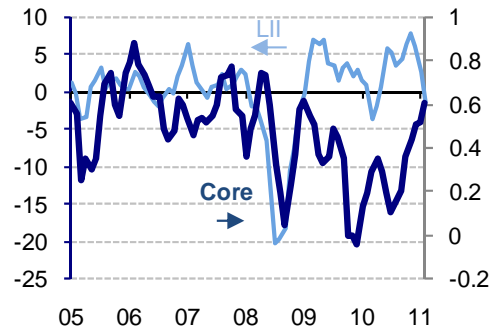
Source: BBVA Research

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



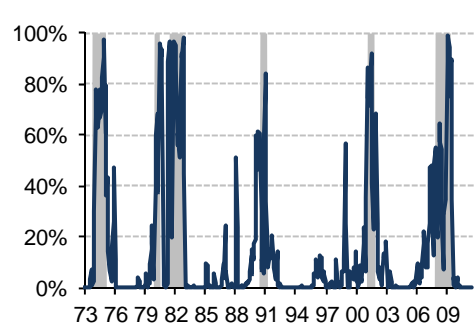
Source: Bloomberg & BBVA Research

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

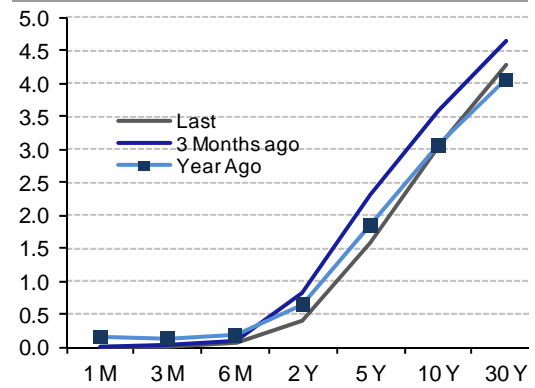
Yield Curve and Interest Rates

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)	3.68	3.66	3.70	6.34
Heloc Loan 30K	5.55	5.53	5.50	5.59
30-year Fixed Mortgage *	4.60	4.51	4.49	4.57
Money Market	0.63	0.62	0.63	0.75
2-year CD	1.06	1.05	1.11	1.55
5-year CD	2.04	2.05	2.05	2.51

* 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

President Barack Obama
Remarks by the President on the Monthly Jobs Report
8 July 2011

"...today's job report confirms what most Americans already know: We still have a long way to go and a lot of work to do to give people the security and opportunity that they deserve."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
12-Jul	Trade Balance (Bn)	MAY	-43	-44	-43.7
12-Jul	FOMC Meeting Minutes	-	-	-	-
13-Jul	Import Price Index (MoM)	JUN	0.2%	-0.6%	0.2%
13-Jul	Producer Price Index (MoM)	JUN	-0.1%	-0.2%	0.2%
13-Jul	PPI Ex Food & Energy (MoM)	JUN	0.1%	0.2%	0.2%
14-Jul	Advance Retail Sales	JUN	0.1%	0.0%	-0.2%
14-Jul	Retail Sales Ex Auto & Gas	JUN	0.2%	0.4%	0.3%
14-Jul	Initial Jobless Claims	9-Jul	410k	410K	418K
14-Jul	Consumer Price Index (MoM)	JUN	0%	0%	0.2%
14-Jul	CPI Ex Food & Energy (MoM)	JUN	0.2%	0.2%	0.3%
15-Jul	Empire Manufacturing	JUL	4.5	4.2	-7.8
15-Jul	Industrial Production	JUN	0.2%	0.3%	0.1%
15-Jul	Capacity Utilization	JUN	77.0	77.0	76.7
15-Jul	U. of Michigan Confidence	JUL	72.0	72.5	71.5

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