

# Weekly Watch

U.S.

## Highlights

25 July 2011  
Economic Analysis

U.S.

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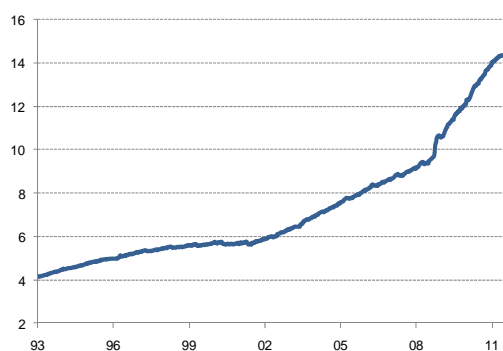
### Political brinksmanship likely to impact passage of debt legislation

President Obama's endorsement of a \$3.7tr debt reduction and debt ceiling package proposed by the "Gang of Six" led to a bounce-back in the financial markets on Tuesday, with the S&P 500 up 21 points (1.6%). The momentum slowed, however, after House Republicans remained firm on avoiding tax increases. Currently, details suggest the bill will cut \$1.4tr in discretionary spending and \$740M in entitlements. In addition, the plan proposed tax revenue increases that would expand the tax collection base and abolish the alternative minimum tax. An alternative plan passed by the House included a constitutional debt limit amendment. The ultimate ratification is improbable because the democratic majority in the Senate would likely block its passage and the bill is almost assured a presidential veto. The procedural implications of House and committee approval are increasing the political brinksmanship, with little time to accommodate such opposition. It appears any long-term plan will be unattainable due to committee and budgetary procedural requirements. However, the White House softened its stance in regards to short-term solutions, which opened the possibility for a debt ceiling agreement by next week.

### Housing starts exceed consensus, existing home sales effectively unchanged

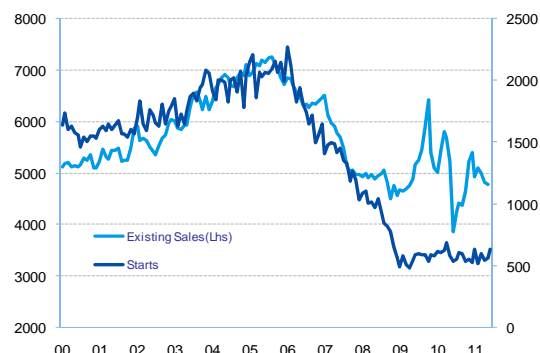
Once again, the housing market indicators offer opposing views in the short term but are consistent with positive long-term growth prospects. Tuesday's monthly housing starts release exceeded expectations, increasing 14.6% MoM to 629k new housing starts for June (also up 16.7% YoY). As expected, starts of 5 or more units led the group with 15k more units than the previous month. Strong rental demand suggests the trend in multi-unit housing starts should continue. In addition, future homebuilder expectations are high, suggesting that builders are incorporating strong forthcoming residential demand into today's construction. However, existing home sales declined to an annualized rate of 4.77M for June, implying demand for existing inventories is still low. As for future market expectations, it is important to remember the bifurcation in the housing market between distressed and non-distressed. Existing home sales should slow as the inventories of distressed properties grow. However, indications of increasing demand for new homes could foreshadow strong housing starts in the 2h11.

Chart 1  
U.S. Debt Outstanding (\$Tr)



Source: U.S. Treasury Department

Chart 2  
Existing Home Sales & Housing Starts (k)



Source: NAR &amp; Census Bureau

## Week Ahead

### Consumer Confidence (July, Tuesday 10:00 ET)

Forecast: 57.9

Consensus: 58.3

Previous: 58.5

Consumer confidence is expected to decline in July for the third consecutive month, mainly due to the unenthusiastic employment outlook. Less favorable labor market conditions are likely to weigh on personal spending habits, with fewer consumers foreseeing improvements over the next six months. Falling gas prices may help to balance the impact of the disappointing employment situation, however we expect that uncertainty regarding future earnings will drive down overall consumer activity.

### Durable Goods Orders (June, Wednesday 8:30 ET)

Forecast: -0.1%

Consensus: 0.3%

Previous: 1.9%

Significant headwinds in the manufacturing sector, along with historically high inventories, which jumped 13.2% in the past 12 months, suggest that new durable goods orders will slow in June. Auto supply disruptions and commodity prices jumps in June, will also add to the MoM decline. However, new orders for airplanes could offset some of the negative factors. The general 2Q11 economic slowdown suggests there could be a slowdown in new orders, but does not suggest a negative growth trajectory for the 2H11.

### Employment Cost Index (1Q11, Friday 8:30 ET)

Forecast: 0.5%

Consensus: 0.5%

Previous: 0.6%

The Employment Cost Index is expected to increase slightly from 1Q11 for the 3-month period ending June 2011. However, the discouraging employment conditions are likely to contribute to slower QoQ growth compared with last quarter. Wages and salaries, which make up 70% of total compensation costs, have remained relatively unchanged in the second quarter, while benefits have been on an upward trend. We expect the index to stay in line with our baseline inflation outlook in which labor costs are stable.

### Gross Domestic Product, Advanced (2Q11, Friday 9:30 ET)

Forecast: 1.7%

Consensus: 1.8%

Previous: 1.9%

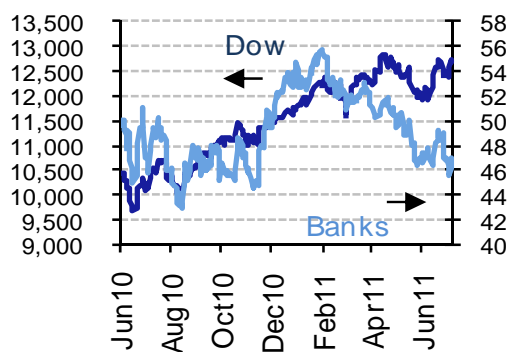
The deteriorating economic condition suggests slower growth in 2Q11. Consumer indicators including confidence survey's, retails sales, and personal consumption expenditures were down from 1Q11 readings. In addition, manufacturing survey reports were below 1Q11 levels, and combined with slow residential investment and moderated core capital goods production, point to QoQ deceleration in private investment. Furthermore, public investment will continue to decline as state and local governments address budgetary issues and federal debt policies restrict fiscal spending. In regards to net exports, we expect the continued expansion in imports to offset the acceleration in exports in the 2Q11.

### Market Impact

The GDP report will be the central focus of this week's releases. Slow 1Q11 growth and struggling labor markets shifted growth expectations. A strong GDP report could ease worries and offset some of the uncertainty surrounding the debt negotiations. In addition, markets will have more information with regard to consumer demand expectations.

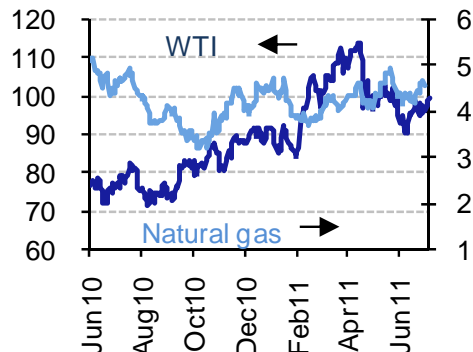
## Financial Markets

Graph 3  
Stocks (Index, KBW)



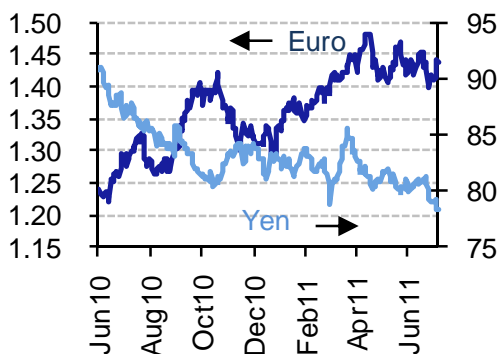
Source: Bloomberg & BBVA Research

Graph 4  
Commodities (Dpb & DpMMBtu)



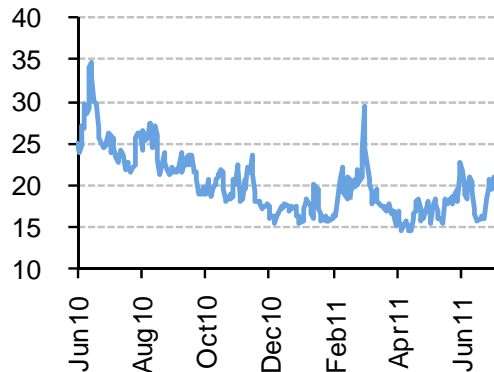
Source: Bloomberg & BBVA Research

Graph 5  
Currencies (Dpe & Ypd)



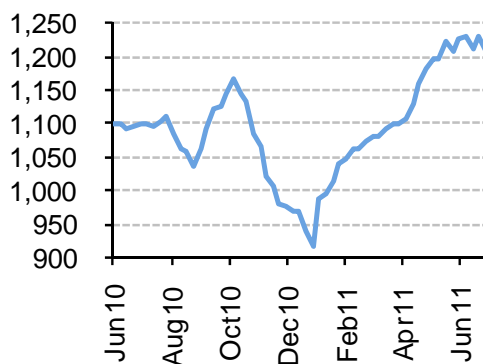
Source: Bloomberg & BBVA Research

Graph 6  
Volatility (Vix, Index)



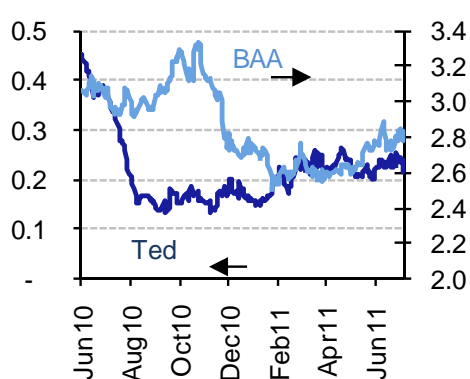
Source: Bloomberg & BBVA Research

Graph 7  
Commercial Paper Issuance (US\$Bn)



Source: Bloomberg & BBVA Research

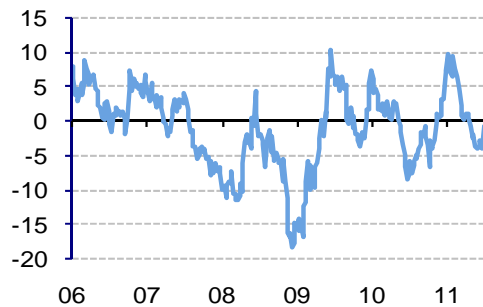
Graph 8  
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

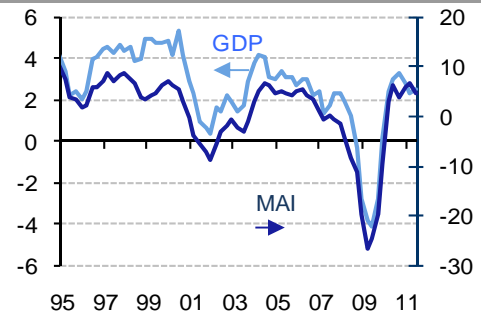
### Economic Trends

Graph 9  
BBVA US Weekly Activity Index  
(3 month % change)



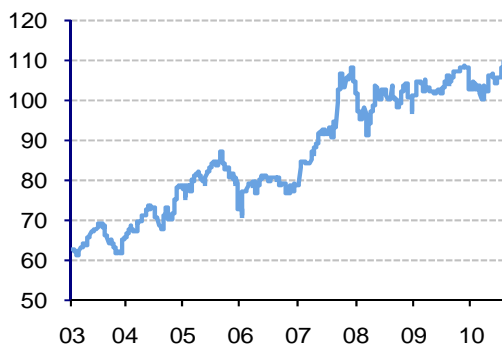
Source: BBVA Research

Graph 10  
BBVA US Monthly Activity Index & Real Gross Domestic Product  
(4Q % change)



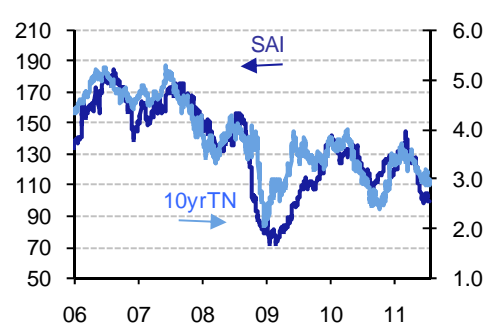
Source: BBVA Research & BEA

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



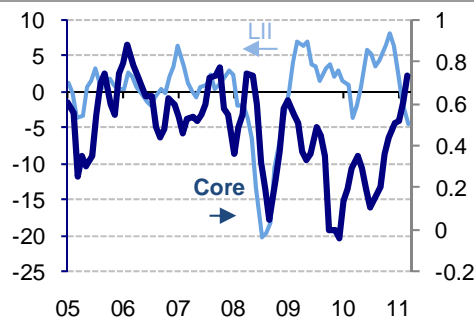
Source: BBVA Research

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



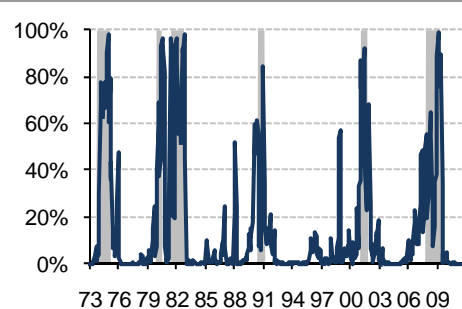
Source: Bloomberg & BBVA Research

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, %)



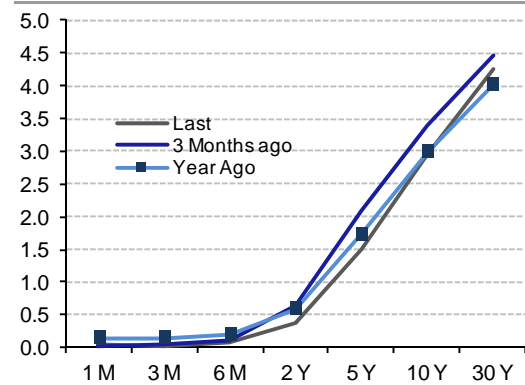
Source: BBVA Research

## 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)	3.99	3.96	3.91	6.17
Heloc Loan 30K	5.58	5.61	5.52	5.56
30-year Fixed Mortgage *	4.52	4.51	4.50	4.56
Money Market	0.60	0.58	0.62	0.75
2-year CD	1.04	1.05	1.05	1.51
5-year CD	2.04	2.04	2.05	2.46

\* 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

Timothy Geithner  
A Dodd-Frank Retreat Deserves a Veto,  
20 July 2011

*"Too many Americans are still suffering from the pain of the financial crisis. We owe them a financial system with better protections against abuse and catastrophic risk."*

## Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
19-Jul	S&P/CS Composite-20 YoY	MAY	-4.4%	-4.6%	-4.0%
19-Jul	S&P/CaseShiller Home Price Ind	MAY	139.80	-	138.84
19-Jul	Consumer Confidence	JUL	57.9	56.0	58.5
19-Jul	New Home Sales	JUN	332K	322K	319K
20-Jul	New Home Sales MoM	JUN	4.1%	0.9%	-2.1%
20-Jul	Durable Goods Orders	JUN	0.0%	0.3%	1.9%
21-Jul	Durables Ex Transportation	JUN	-0.2%	0.5%	0.6%
21-Jul	Fed's Beige Book	-	-	-	-
21-Jul	Initial Jobless Claims	22-Jul	415K	415K	418K
21-Jul	Continuing Claims	16-Jul	3705K	3700K	3698K
21-Jul	Pending Home Sales MoM	JUN	0.0%	-2.0%	8.2%
21-Jul	Annual Revisions: GDP	-	-	-	-
21-Jul	Employment Cost Index	2Q	0.5%	0.5%	0.6%
21-Jul	GDP QoQ (Annualized)	2Q A	1.7%	1.8%	1.9%
21-Jul	Personal Consumption	2Q A	2.0%	0.9%	2.2%
21-Jul	GDP Price Index	2Q A	1.9%	2.0%	2.0%
21-Jul	Core PCE QoQ	2Q A	2.4%	2.2%	1.6%
21-Jul	Chicago Purchasing Manager	JUL	60.4	60.2	61.1
21-Jul	U. of Michigan Confidence	JUL F	65.0	64.0	63.8

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