

Weekly Watch

U.S.

Highlights

1 August 2011
Economic Analysis

U.S.

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Risk of deadline extension if no debt deal by August 2nd

The U.S. debt ceiling standoff has brought increasing concerns and uncertainty to global markets. The Boehner proposal will reach the House floor on Friday but it appears to be lacking sufficient Republican support and even if passed, it will likely be dead on arrival in the Senate. The main question is why those involved in the debate are not acting with a sense of urgency. Recently, the Treasury announced that they would be able to prioritize bond repayments, essentially allowing for an additional two weeks for debate. If this is the case, the additional time may be enough for the U.S. to avoid a default, reach an agreement on government deficit reduction, and raise the debt ceiling. However, we believe market expectations are rooted around an August 2nd hard deadline, and thus will react negatively if there is no deal before then. In the event of a lack of borrowing authority, President Obama all but explicitly stated that debt service will be the top priority and will receive primacy over federal disbursements including social security and veterans benefits. Although ratings agencies have backed off prior threats, the probability of a downgrade will increase each day a compromise is not reached. If the August 2nd deadline is extended, negotiations over spending cuts and tax increases may be put on hold in order to ensure that the debt ceiling is increased in a timely manner.

Real GDP growth sluggish in 2Q11, lower-than-expected revisions for 1Q11

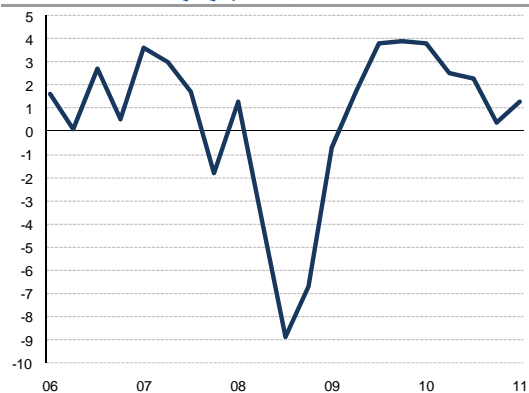
Advance GDP data for 2Q11 was sluggish, coming in at 1.3% for 2Q11 (annualized) on a seasonally adjusted basis. Significant reductions to inventories and net exports estimates led to the downward revision to 0.4% (QoQ annualized) in 1Q11. Negative contributions to real GDP growth stemmed from state and local government spending, which offset positive contributions from Federal government expenditures. PCE contributed the least to GDP growth in two years and slowed to 0.1%. QoQ. This is consistent with weak labor markets, high energy prices, and reduced consumer confidence. Net exports, nonresidential fixed investment, private inventory investment, and federal government spending all contributed positively to 2Q11 GDP. However, we maintain our view for slow growth in 2011 with some acceleration in 2012.

Chart 1
Credit Default Swap on 5Yr U.S. Debt (Euro)



Source: Bloomberg

Chart 2
Real GDP Growth (QoQ%, SAAR)



Source: BEA

Week Ahead

ISM Manufacturing Index (July, Monday 10:00 ET)

Forecast: 54.0	Consensus: 55.0	Previous: 55.3
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Preliminary data for the month of July suggests that the ISM index will decline MoM but imply general economic growth. Moderating price pressures should partially offset the downside risk to manufacturer's demand expectations. Furthermore, regional Federal Reserve manufacturing reports suggest stagnant or possibly decelerating sector growth but do not signal depressed activity. In addition, persistently high jobless claims are an indication that manufacturing employment expectations are unlikely to improve MoM for July. Production will likely slow in reaction to declines in June new orders.

Construction Spending (June, Monday 10:00 ET)

Forecast: -0.2%	Consensus: 0.0%	Previous: -0.6%
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Oversupply of commercial buildings, residential homes, and office units suggests that construction spending will continue its no-growth holding pattern but decline slightly MoM. Tighter public lending, in reaction to imminent federal fiscal cuts, will likely continue the public construction descent. In addition, stagnant sector employment growth implies that forward-looking expectations are constant and are below levels necessary to induce construction. Although multi-family residential construction has strengthened in recent months, it comprises only a small portion of the market and thus will do little to offset the negative market forces.

Personal Income and Outlays (June, Tuesday 8:30 ET)

Forecast: 0.1%, 0.2%	Consensus: 0.2%, 0.2%	Previous: 0.3%, 0.0%
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Personal income and spending are expected to grow in June, although weak labor market conditions likely contributed to slower MoM income growth. Downward trends in employee compensation and consumer confidence have increased uncertainty regarding future income. However, lower gas prices in June most likely led to higher disposable income, encouraging less conservative spending for the month. Thus, we expect that reduced prices offset the discouraging employment situation and helped to stimulate consumer activity.

Nonfarm Payrolls, Unemployment Rate (July, Friday 8:30 ET)

Forecast: 70K, 9.2%	Consensus: 90K, 9.2%	Previous: 18K, 9.2%
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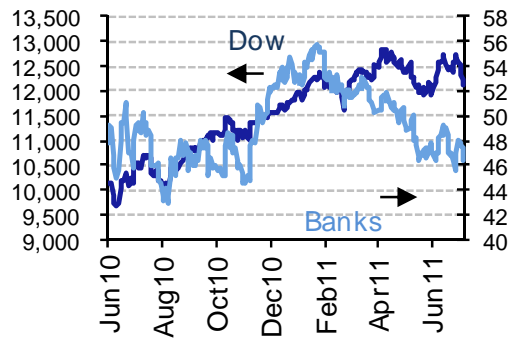
Nonfarm payrolls are expected to improve in July after last month's disappointing employment report, though the outlook is conservative. Moderate employment creation is expected to continue in the services, manufacturing, and construction sectors, and a decreasing trend in jobless claims may indicate stronger labor market growth. However, sustained government spending cuts are likely to weigh down overall nonfarm payrolls in July. The general consensus is that the employment situation is still weak, and we see no indication that the unemployment rate will change.

Market Impact

With the debt ceiling deadline only days away, concerns of a default are high. Markets are impatiently awaiting action by Tuesday, hoping that an agreement will reduce some uncertainties in the economy. In addition, a positive employment report could ease some worries following lower-than-expected GDP figures.

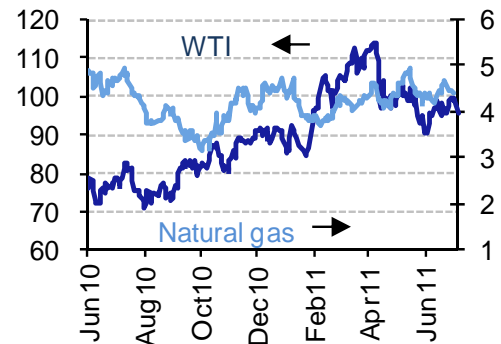
Financial Markets

Graph 3
Stocks (Index, KBW)



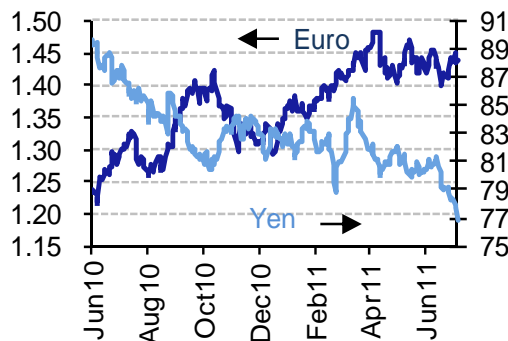
Source: Bloomberg & BBVA Research

Graph 4
Commodities (Dpb & DpMMBtu)



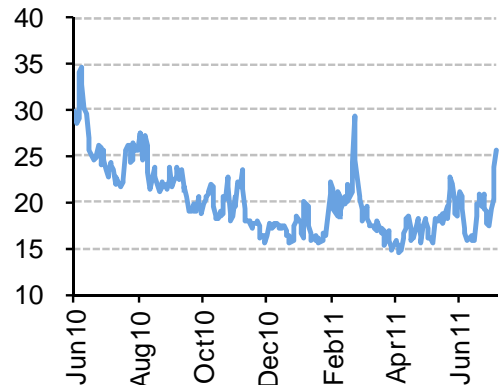
Source: Bloomberg & BBVA Research

Graph 5
Currencies (Dpe & Ypd)



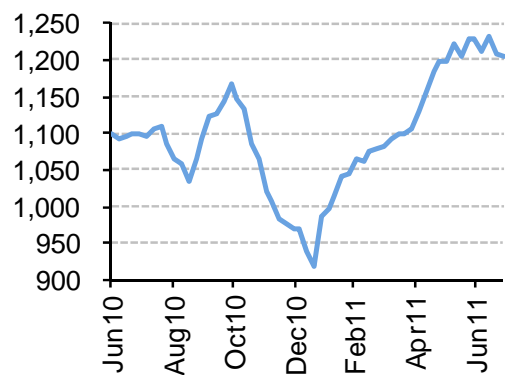
Source: Bloomberg & BBVA Research

Graph 6
Volatility (Vix, Index)



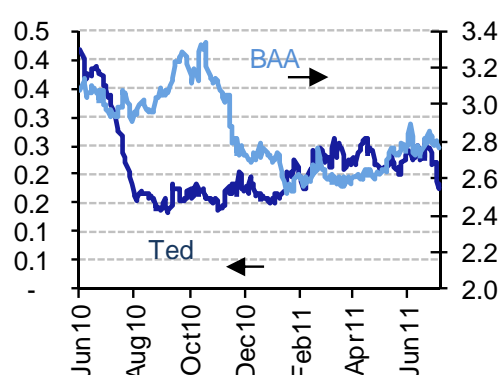
Source: Bloomberg & BBVA Research

Graph 7
Commercial Paper Issuance (US\$Bn)



Source: Bloomberg & BBVA Research

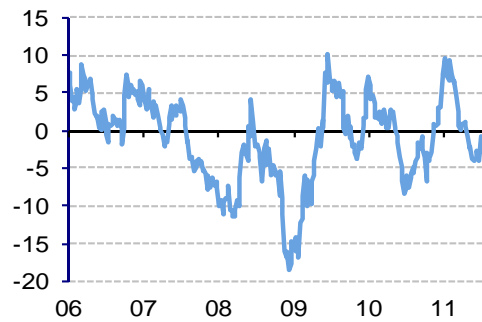
Graph 8
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

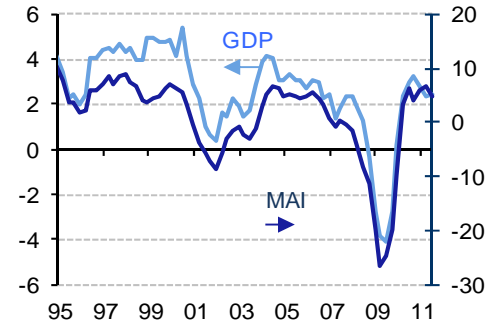
Economic Trends

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)



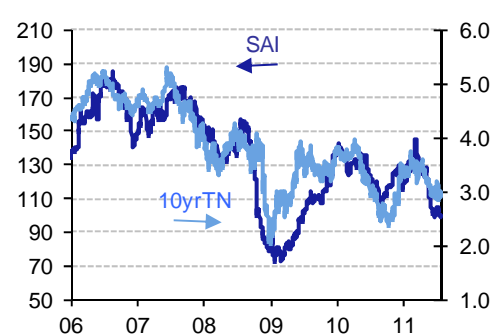
Source: BBVA Research & BEA

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



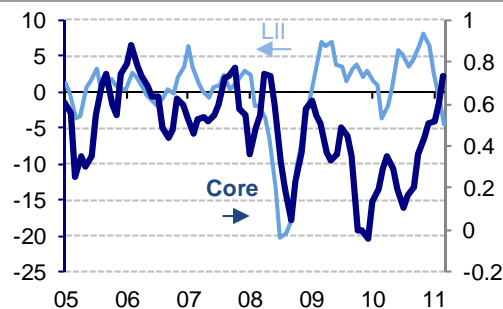
Source: BBVA Research

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



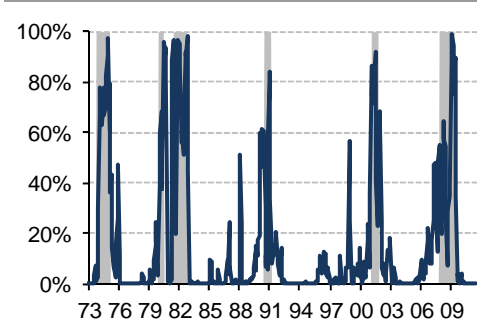
Source: Bloomberg & BBVA Research

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

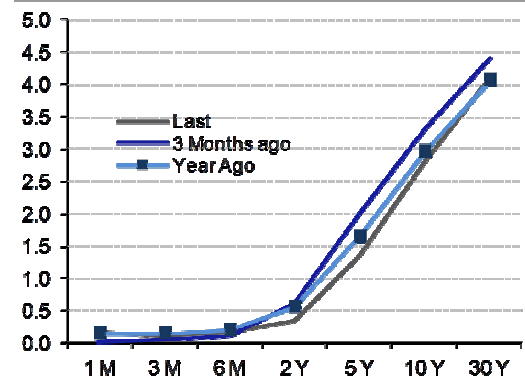
Yield Curve and Interest Rates

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)	3.94	3.99	3.66	6.16
Heloc Loan 30K	5.56	5.58	5.53	5.55
30-year Fixed Mortgage *	4.55	4.52	4.51	4.54
Money Market	0.58	0.60	0.62	0.75
2-year CD	1.04	1.04	1.05	1.48
5-year CD	2.01	2.04	2.05	2.43

* 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 Barack Obama
Obama Urges Action as Debt Stalemate Continues.
29 July 2011

"The time for putting party first is over. The time for compromise on behalf of the American people is now. And I'm confident that we can solve this problem."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
1-Aug	Construction Spending MoM	JUN	-0.2%	0.0%	-0.6%
1-Aug	ISM Manufacturing	JUL	54.0	55.0	55.3
2-Aug	Annual Revisions: Personal Income and Spending				
2-Aug	Personal Income	JUN	0.1%	0.2%	0.3%
2-Aug	Personal Spending	JUN	0.2%	0.2%	0.0%
2-Aug	PCE Core (MoM)	JUN	0.1%	0.2%	0.3%
2-Aug	PCE Core (YoY)	JUN	1.4%	1.4%	1.2%
2-Aug	Total Vehicle Sales	JUL	11.90M	11.80M	11.41M
2-Aug	Domestic Vehicle Sales	JUL	9.20M	9.30M	8.95M
3-Aug	ADP Employment Change	JUL	90K	98K	157K
3-Aug	ISM Non-Manf. Composite	JUL	53.70	53.70	53.30
3-Aug	Factory Orders	JUN	-0.9%	-0.7%	0.8%
4-Aug	Initial Jobless Claims	30-Jul	405K	405K	398K
4-Aug	Continuing Claims	23-Jul	3700K	3698K	3703K
5-Aug	Change in Nonfarm Payrolls	JUL	70K	90K	18K
5-Aug	Change in Private Payrolls	JUL	100K	118K	57K
5-Aug	Unemployment Rate	JUL	9.2%	9.2%	9.2%
5-Aug	Consumer Credit	JUN	5.00	5.00	5.08

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