

Weekly Watch

U.S.

Highlights

15 August 2011
Economic Analysis

U.S.

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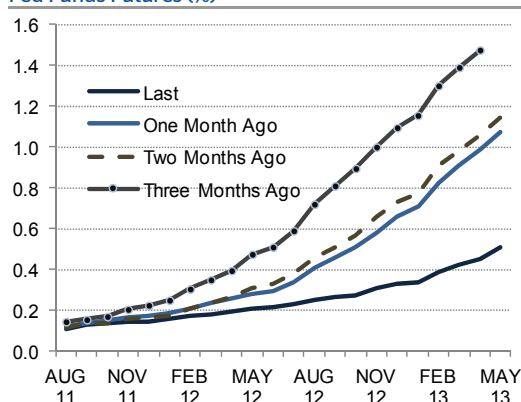
FOMC downgrades growth assessment, transitory factors no longer to blame

In response to the US credit downgrade and continued weakness in the economy, the Federal Reserve downgraded their assessment of growth and now sees increased downside risks. The FOMC believes that the recent slowdown in economic activity is only partly explained by transitory factors, a major contrast to previous statements which emphasized a better second half for the US after temporary factors dissipated. Assuming that the FOMC's estimate of long-run potential growth remains constant, the announcement reveals that the Fed believes excess resource slack will persist for longer than previously estimated. As a result, the FOMC decided to tweak its extended period language to read "exceptionally low levels for the federal funds rate at least through mid-2013." This is the most the Fed could instigate given the current state of economic growth and inflation. At the very least, the Fed is hoping to reduce interest rate volatility to streamline business conditions slightly for pro-growth purposes. The key insight to the statement is the phrasing "currently anticipates", suggesting that changing data may cause the Fed to anticipate something different at a later meeting. As such, we do not view the new guidance as 100 percent ironclad. Importantly, three FOMC members dissented to the announcement, which underscores the degree of uncertainty within the FOMC over the economic outlook.

Jump in headline retail sales driven by near universal expansion

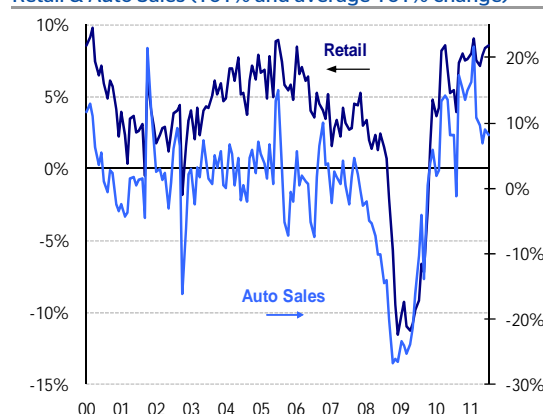
The advance retail sales report for July indicated MoM growth in most sectors, excluding building materials, sporting goods, general merchandise, and food services sales, which declined only slightly. The near ubiquitous increase across industries facilitated the 0.5% MoM increase to both headline retail sales and retail sales excluding autos. Auto sales grew for the second consecutive month following a sluggish 1H11, most likely due to supply chain normalization after the earthquakes in Japan. Furthermore, the declining wedge between supplier prices and demand, previously reported in the Beige book, likely facilitated the sales boost. Despite this jump in retail sales, crude oil prices dropped 18.6% since August 1st, possibly foreshadowing a pull back in retail gasoline sales in 3Q11. In addition, consumer confidence continues to fall, indicating that the rise in sales may have more to do with increasing prices than a boost in consumer activity. However, the retail sales report is not consensus shifting and our risk scenario will not be impacted.

Graph 1
Fed Funds Futures (%)



Source: BBVA Research and Bloomberg

Graph 2
Retail & Auto Sales (YoY% and average YoY% change)



Source: US Census Bureau

Week Ahead

Housing Starts (July, Tuesday 8:30 ET)

Forecast: 610k

Consensus: 600k

Previous: 629k

New home starts are likely to decrease slightly in July due to general slowdown in the housing market. Despite a large jump in June, the outlook for new residential construction is pessimistic and confidence among builders is low. Demand for new homes has been suppressed by continued weakness in the labor market and uncertainty regarding future income. Furthermore, credit conditions are likely to remain tight and continue to discourage construction of new homes. Thus, we expect housing starts to trend downwards in the coming months.

Industrial Production (July, Tuesday 9:15 ET)

Forecast: 0.1%

Consensus: 0.5%

Previous: 0.2%

Slow economic activity and weak demand expectations point to low MoM industrial production growth in July. Industrial production stalled after an uptick in March, declining in two of the three reports since. The decline is consistent with the recent GDP release of below average growth for 2Q11, which is also expected to continue throughout 2H11. Exports, which buoyed 1H11 domestic manufacturing, also declined in May and June. Furthermore, auto sales reports and manufacturing surveys in July showed a large drop in auto production as well as reduced manufacturer expectations, further eroding any optimistic notions.

Consumer Price Index (July, Thursday 8:30 ET)

Forecast: 0.2%, 0.2%

Consensus: 0.2%, 0.2%

Previous: -0.2%, 0.3%

After a torrent start to 2011, headline consumer prices declined 0.2% in June. Headline consumer price inflation is expected to be minimal in July given that energy price increases have slowed and other major contributors to inflation are likely to remain stable due to weak economic activity. Furthermore, low consumer demand should offset any increases in commodity prices, limiting runaway food inflation. In addition, the housing price index, a large contributor to core prices, has been increasing but remained relatively stable throughout 2011, indicating that there is limited upside risk to core prices in July.

Existing Home Sales (July, Thursday 10:00 ET)

Forecast: 4.70M

Consensus: 4.90M

Previous: 4.77M

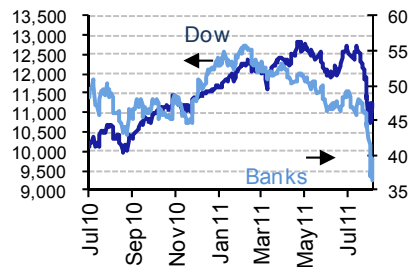
Low credit availability and continued weakness in the employment situation are expected to weigh on existing home sales in July. Increased economic uncertainties have contributed to a negative outlook for the housing market, and residential demand is unlikely to increase in the coming months. Growth of pending home sales has slowed and expectation for future sales is low. Thus, we expect existing home sales to decrease slightly from June.

Market Impact

This week markets will focus on consumer and industrial demand, hoping for stronger economic activity. Growing industrial production could indicate a positive shift to the current slowdown. However, continued weakness in the housing market may weaken market expectations for a strengthened recovery in 2H11.

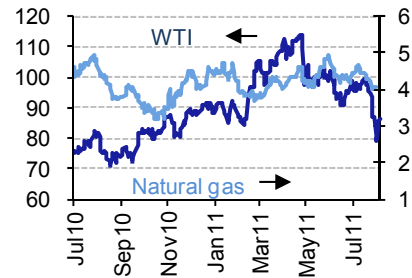
Financial Markets

Graph 3
Stocks (Index, KBW)



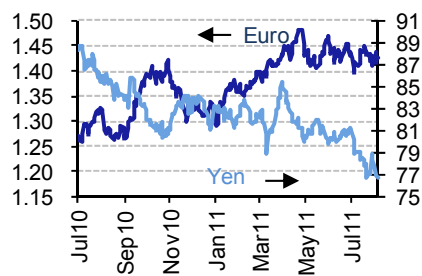
Source: Bloomberg & BBVA Research

Graph 4
Commodities (Dpb & DpMMBtu)



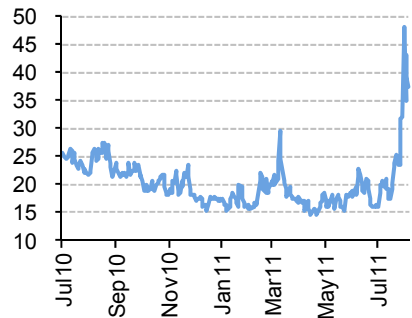
Source: Bloomberg & BBVA Research

Graph 5
Currencies (Dpe & Ypd)



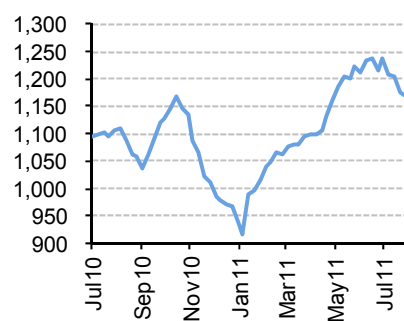
Source: Bloomberg & BBVA Research

Graph 6
Volatility (Vix, Index)



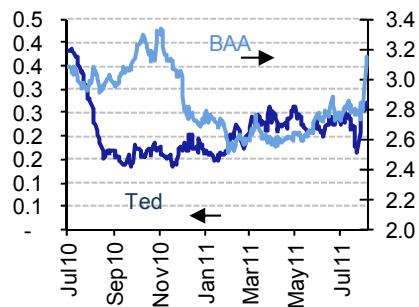
Source: Bloomberg & BBVA Research

Graph 7
Commercial Paper Issuance (US\$Bn)



Source: Bloomberg & BBVA Research

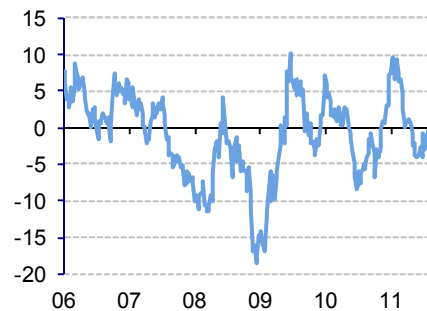
Graph 8
TED & BAA Spreads (%)



Source: Bloomberg & BBVA Research

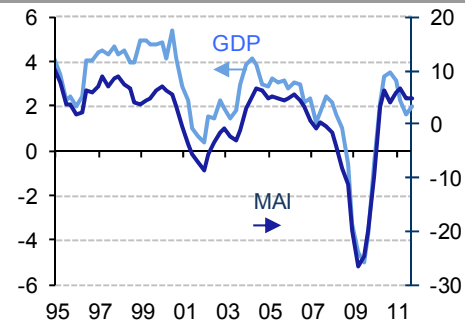
Economic Trends

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)



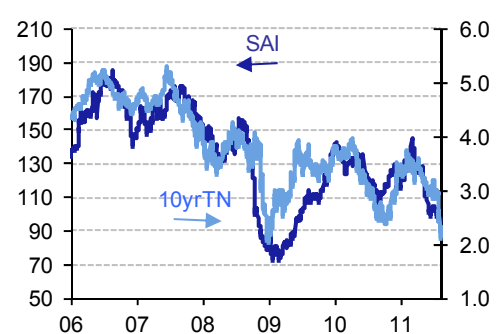
Source: BBVA Research & BEA

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



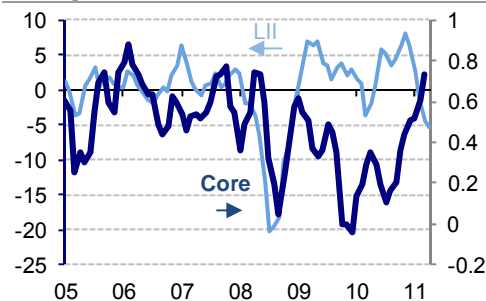
Source: BBVA Research

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



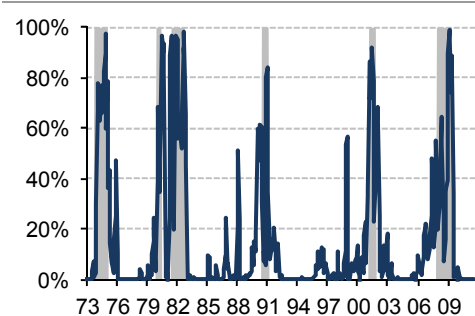
Source: Bloomberg & BBVA Research

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

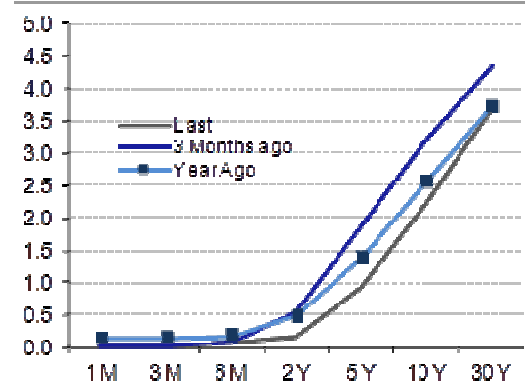
Yield Curve and Interest Rates

Table 1
Key Interest Rates, %

	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)	4.31	4.30	3.96	6.09
Heloc Loan 30K	5.55	5.54	5.61	5.54
30-year Fixed Mortgage *	4.32	4.39	4.51	4.44
Money Market	0.57	0.58	0.58	0.73
2-year CD	1.04	1.04	1.05	1.45
5-year CD	2.00	2.01	2.04	2.38

* 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

William Dudley, President of the New York Federal Reserve
Job Creation in the Region (New York)
12 August 2011

"The statement issued by the FOMC earlier this week presents a sober assessment of the state of the U.S. economy."

Economic Calendar

Date	Event	Period	Forecast	Survey	Previous
15-Aug	Empire State Manufacturing Survey	AUG	-1.00	0.00	-3.76
15-Aug	NAHB Housing Market Index	AUG	15.00	15.00	15.00
16-Aug	Housing Starts	JUL	610K	600K	629K
16-Aug	Housing Starts (MoM)	JUL	-3.02%	-4.60%	14.57%
16-Aug	Building Permits	JUL	609K	605K	617K
16-Aug	Building Permits (MoM)	JUL	-0.80%	-1.90%	2.50%
16-Aug	Import Prices	JUL	0.10%	-0.10%	-0.50%
16-Aug	Export Prices	JUL	0.00%	--	0.10%
16-Aug	Industrial Production	JUL	0.10%	0.50%	0.20%
16-Aug	Capacity Utilization	JUL	76.80%	76.90%	76.70%
17-Aug	Producer Price Index (MoM)	JUL	-0.10%	0.10%	-0.40%
17-Aug	PPI Ex Food & Energy (MoM)	JUL	0.20%	0.20%	0.30%
18-Aug	Consumer Price Index (MoM)	JUL	0.20%	0.20%	-0.20%
18-Aug	CPI Ex Food & Energy (MoM)	JUL	0.20%	0.20%	0.30%
18-Aug	Initial Jobless Claims	13-Aug	395K	400K	395K
18-Aug	Continuing Claims	6-Aug	3695K	3700K	3688K
18-Aug	Existing Home Sales	JUL	4.70M	4.90M	4.77M
18-Aug	Existing Home Sales (MoM)	JUL	1.47%	2.70%	-0.80%
18-Aug	Philadelphia Fed Survey	AUG	1.00	3.90	3.20
18-Aug	Leading Indicators	JUL	-0.10%	0.20%	0.30%

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