# Weekly Watch

#### 22 August 2011 Economic Analysis

U.S.

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# **Highlights**

#### Industrial production in July surpasses expectations

Industrial production appears to be on the rebound, growing 0.9% MoM in July following an upwardly revised 0.4% in June. The consumer goods index increased slightly, mostly due to a 3.6% MoM jump in durable goods. In particular, automotives contributed most to the durable goods increase, growing 5.9% following a -0.7% decline in June. Overall, the manufacturing sector led industrial production growth, increasing for the third consecutive month. Other major sectors, including utilities and mining, also saw MoM gains. In addition, capacity utilization increased to 77.5% from last month's index of 76.7%, indicating that output is likely to continue growing in the near future. Industrial production is approaching pre-recession levels, at 94.2% of its 2007 average and improving 3.7% on a YoY basis. In sum, today's industrial production data may signal improvements in economic activity and a better-than-expected 2H11 recovery.

#### Gasoline and food costs drive headline CPI growth in July

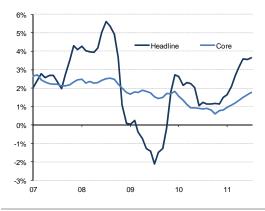
The consumer price index (CPI) jumped in July, growing 0.5% MoM after falling 0.2% in June on a seasonally-adjusted basis. Gasoline and food prices were the main drivers of inflation, increasing 4.7% and 0.4% MoM, respectively. Overall energy prices increased 2.8%, rebounding from two consecutive months of deflation. Core CPI also increased, up 0.2%, although at a slower pace than in the previous months. The apparel index rose 1.2%, increasing for the fourth consecutive month and leading core inflation. In addition, shelter prices (mostly lodging) increased 0.3%, the largest jump for the index since June 2008. Despite five months of growth, new vehicle prices were unchanged in July. On a YoY basis, headline inflation rose to 3.6% while core inflation increased from 1.6% to 1.8% in July. While headline CPI jumped significantly in July, inflation concerns are mostly related to food supply as prices are up 4.2% over the past 12 months. Furthermore, energy prices bounced back only partially from June's decline. Core inflation appears to be moderating, with new and used vehicle prices slowing as temporary factors dissipate. Looking forward, the distribution of prices in the CPI continues to suggest an increasing central tendency, and deflation risks have further declined.

Graph 1
Industrial Production & Durable Goods Orders (YoY%)



Source: Federal Reserve and US Census Bureau

Graph 2 Consumer Price Index (NSA YoY%, 1982-84=100)



Source: US Bureau of Labor Statistics



### Week Ahead

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

Forecast: 1.4% Consensus: 2.1% Previous: -1.9%

Durable goods orders are likely to increase slightly in July, mostly due to growth in new orders in the transportation sector. Motor vehicle orders appear to be on the rebound as auto supply chain disruptions have dissipated, and a boost in aircraft orders may skew overall durable goods orders positive. However, given the continued weakness in the manufacturing sector and historically high inventories, we do not expect a significant jump in new orders for July.

#### Gross Domestic Product, Preliminary (2Q11, Friday 8:30 ET)

Forecast: 1.1% Consensus: 1.1% Previous: 1.3%

The combination of lower-than-expected exports and greater-than-anticipated imports suggests that the 2Q11 preliminary release will be revised down. The advanced forecasts released by the BEA anticipated a jump in exports with slowed import growth, however recent releases are pointing to both increased imports and decreased exports. The negative trade headwinds could be offset by increased inventories, although evidence from the Census Bureau suggests that inventories could be less than initially forecasted. As for consumption, weak labor markets and slowed retail sales coincide with low consumer expenditure and therefore the probability of an upward revision to consumption is low.

#### Consumer Sentiment (August, Friday 9:55 ET)

Forecast: 55.5 Consensus: 56.0 Previous: 54.9

Preliminary estimates for consumer sentiment in August surpassed historical lows, suggesting a discouraging outlook for the final report. Growing uncertainties regarding future earnings have weakened consumer activity and increased expectations for a continued slowdown. The string of debt ceiling negotiations followed by the U.S. credit downgrade in early August triggered a growing lack of confidence in the political system and likely had a lasting impact on consumers. Although the employment situation has improved slightly, as suggested by declines in initial jobless claims, we expect consumer sentiment in August to remain low.

#### Ben Bernanke Speech (Friday 10:00 ET)

The U.S. credit ratings downgrade and pending fiscal reforms have directed market attention to hints of the Fed's action from Ben Bernanke's Jackson Hole speech. Despite the Fed's announcement to keep interest rates low until at least mid-2013, uncertainties have increased over whether Bernanke will signal further easing of monetary policy. A series of weak economic data and growing political backlash against Fed policies are likely to cause continued stock market volatility in anticipation of Friday's speech.

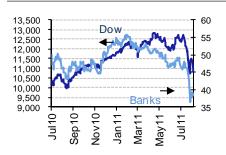
#### Market Impact

The GDP release will be the central focus for the week, most likely confirming a slower-thanexpected recovery for 1H11. Markets will also await news from the Fed for signs of future policy action to promote a stronger economy.



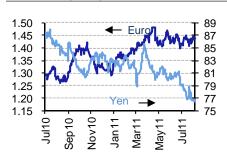
# Financial Markets

Graph 3
Stocks (Index, KBW)



Source: Bloomberg & BBVA Research

Graph 5
Currencies (Dpe & Ypd)



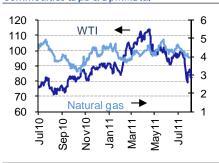
Source: Bloomberg & BBVA Research

Graph 7
Commercial Paper Issuance (US\$Bn)



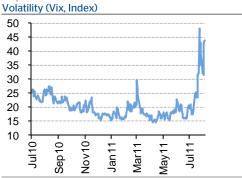
Source: Bloomberg & BBVA Research

Graph 4
Commodities (Dpb & DpMMBtu)



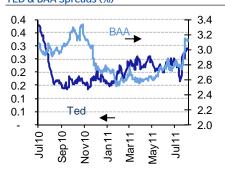
Source: Bloomberg & BBVA Research

Graph 6



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)



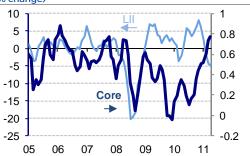
Source: BBVA Research

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



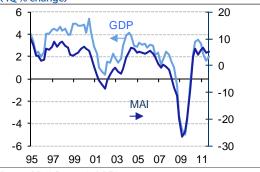
Source: BBVA Research

Graph 13 BBVA US Leading Inflation Index & Core Inflation (QoQ % change)



Source: BLS & BBVA Research

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



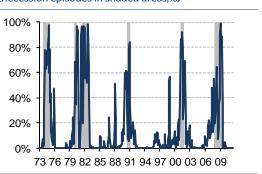
Source: BBVA Research & BEA

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



Source: Bloomberg & BBVA Research

Graph 14 BBVA US Recession Probability Model (Recession episodes in shaded areas,%)



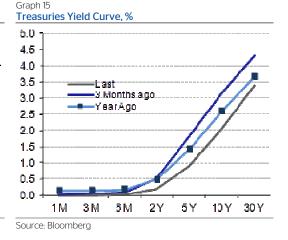
Source: BBVA Research



# Yield Curve and Interest Rates

Table 1
Key Interest Rates, %

	Week	4-Weeks	Year
Last	ago	ago	ago
3.25	3.25	3.25	3.25
13.73	13.73	13.73	13.44
3.87	4.31	3.99	6.10
5.52	5.55	5.58	5.52
4.15	4.32	4.52	4.42
0.57	0.57	0.60	0.71
1.00	1.04	1.04	1.45
1.90	2.00	2.04	2.37
	3.25 13.73 3.87 5.52 4.15 0.57 1.00	Last         ago           3.25         3.25           13.73         13.73           3.87         4.31           5.52         5.55           4.16         4.32           0.57         0.57           100         104	Last         ago         ago           3.25         3.25         3.25           13.73         13.73         13.73           3.87         4.31         3.99           5.52         5.55         5.58           4.75         4.32         4.52           0.57         0.57         0.60           100         104         104



<sup>\*</sup> Freddie Mac National Mortgage Homeowner Commitment 30 Year US

Source: Bloomberg and BBVA Research

# Quote of the Week

Christine Lagarde, IMF Managing Director Don't Let Fiscal Brakes Stall Global Recovery 15 August 2011

"If the global recovery falters, the burden will be borne far and wide. If policymakers can act boldly, act together and act now on these priorities, confidence can be restored and the recovery sustained."

# **Economic Calendar**

Date	Event	Period	Forecast	Survey	Previous
22-Aug	Chicago Fed National Activity Index	JUL	-0.40	-0.48	-0.46
23-Aug	New Home Sales	JUL	305K	312K	312K
23-Aug	New Home Sales (MoM)	JUL	-2.24%	0.00%	-1.00%
24-Aug	Durable Goods Orders	JUL	1.40%	2.10%	-1.90%
24-Aug	Durable Goods Orders Ex Transportation	JUL	0.10%	-0.50%	0.40%
25-Aug	Initial Jobless Claims	20-Aug	400K	405K	408K
25-Aug	Continuing Claims	13-Aug	3700K	3700K	3702K
26-Aug	GDP QoQ Annualized	2Q P	1.10%	1.10%	1.30%
26-Aug	Personal Consumption	2Q P	0.20%	0.20%	0.10%
26-Aug	GDP Price Index	2Q P	2.30%	2.30%	2.30%
26-Aug	Core PCE QoQ	2Q P	2.10%	2.10%	2.10%
26-Aug	Corproate Profits (YoY)	2Q	13.40%		7.80%
26-Aug	U. of Michigan Consumer Sentiment	AUG	55.50	56.00	54.90



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